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FARM CREDIT CRISIS

HEARING

BEFORE THE

SUBCOMMITTEE ON ADMINISTRATIVE PRACTICE AND PROCEDURE

OF THE

COMMITTEE ON THE JUDICIARY UNITED STATES SENATE

NINETY-NINTH CONGRESS

SECOND SESSION

TO

MONITOR FEDERAL PROGRAMS AND POLICIES THAT RELATE TO THE FARM ECONOMY

DES MOINES, IA

SEPTEMBER 3, 1986

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FARM CREDIT CRISIS

WEDNESDAY, SEPTEMBER 3, 1986

U.S. SENATE,
SUBCOMMITTEE ON ADMINISTRATIVE
PRACTICE AND PROCEDURE,
COMMITTEE ON THE JUDICIARY,
Des Moines, IA

The subcommittee met, pursuant to notice, at 9 a.m., in the city council chamber, city hall, Des Moines, IA, Hon. Charles E. Grassley (chairman of the Subcommittee on Administrative Practice and Procedure) presiding.

OPENING STATEMENT OF SENATOR CHARLES E. GRASSLEY, CHAIRMAN, SUBCOMMITTEE ON ADMINISTRATIVE PRACTICE AND PROCEDURE

Senator **GRASSLEY**. I know it's 5 minutes early and traditionally we get started about 10 minutes late, but I would like to go ahead and use the first 5 minutes for probably a 2- or 3-minute opening statement and get started with the first panel because I would like to complete by 12 o'clock if we can. And I plan on doing that, particularly if the people who speak stick to the 6 or 7 minutes that we have allotted each person.

As a matter of procedure let me say that if your entire statement is longer than 6 or 7 minutes it will be included in the record as if read in its entirety, so anything you have to say will be in the record. So that's why we ask for summary in case your statement was longer than that.

Now, this hearing is being called in my capacity as chairman of the Senate Judiciary Subcommittee on Administrative Practice and Procedure, a subcommittee that has general oversight jurisdiction, and it's the same subcommittee that 1 year ago held a hearing on roughly the same subject at the House of Representatives chamber on capitol hill here in Des Moines.

The purpose of this hearing is to monitor Federal programs and policies as they relate to the farm credit crisis in Iowa. As you might know I spend a great deal of my time in Washington trying to ensure that Federal programs are working as they should to help the farm economy. And to pursue this I need to hear comments and complaints about the operation of the Farm Credit System, commercial lenders and the Farmers Home Administration.

I need to know if Federal programs are producing the intended results of helping hard-pressed borrowers and the lenders who are trying to help them. If there are problems, I want to know what they are and what can be done to correct them. There could be another credit crunch next winter and spring and we need to be prepared for it.

What I am trying to do here today is to find out what the problems are so that they can be corrected before spring planting is upon us. Now, we all know too well that the wheels of government in Washington turn too slowly and if we are to correct problems with the Farm Credit System, the Farmers Home Administration or the regulations of commercial banks, we need to start now so that credit assistance is available next spring.

If we discover problems with Federal credit programs in March or April of next year, it will then be too late to help farmers line up credit for spring planting. Now, just as an example, last spring farmers and bankers began telling my office that the Farmers Home Administration interest rate buy-down program wasn't working because loans with balloon payments were eligible. A farmer who is in financial trouble will almost always have a balloon on his loan because he is carrying more debt than can be serviced at current income levels. If balloons are ineligible, then the farm borrowers who need this program the most will not qualify.

I wrote the Secretary of Agriculture about the need to include loans with balloon payments in the interest rate buy-down program and I pushed for an amendment on an appropriation bill which corrected this regulatory mistake. Just 2 weeks ago Farmers Home Administration finally came up with new regulations. There are plenty of borrowers who could have benefited from the interest rate buy-down program last spring who weren't able to use the program because of this stupid regulation.

I want to make sure that programs that are supposed to help agriculture are really doing the job. The problems need to be corrected now so that credit is available next spring. I have requested a variety of witneses to come before my subcommittee today.

I want the Farm Credit System officials to talk about their new polices. This system hasn't asked Congress for any financial assistance and I am still making up my mind whether I would support such legislation if a need is demonstrated. If the system isn't working with its member borrowers to restructure debts, I have to question where Federal assistance would go if it were granted as well as why Congress should even give it in the first place.

I also intend to pursue the question of the system's high interest rates. I have written several letters on this subject and while we have seen rates come down some, it's not enough. I have asked a group of System board members to testify about their experiences with the System.

I have asked bankers, commercial bankers, that is, to testify about their efforts to work with their borrowers and what effect Federal policies are having on them. I have held two hearings on bank examinations and am continuing to work on this issue. If Federal regulators are forcing bankers to foreclose, then I want to know that.

Representatives of Farmers Home Administration and the State Farmer/Creditor Mediation Service, which is a new service set up by the legislature this year, will testify about their efforts and suggestions on what needs to be done.

We are not going to find any magic answers to the farm credit crisis here this morning, but we can make exisitng programs work as well as possible and we can stop Government practices that are very counterproductive. We need to stabilize the declining farm economy so that Iowa can begin to pull out of the present tailspin. There has been enough examination of the causes of the farm crisis. Now it's time to work on the solution.

I would like to have Marvin Duncan and James Mullins come to the witness table. They are on our panel and there's a list of the entire program up here for some of you in the audience who don't have the program so that you can know ahead of time who is going to be testifying.

Marvin Duncan is a member of the Farm Credit Administration board of directors. He along with the rest of the board members set Farm Credit Administration policy and, of course, they have to live within laws passed by the Congress.

It's my understanding that you and Frank Naylor moved the Farm Credit Administration boardmeeting back which was scheduled for this morning in order for you to be here and to accommodate this subcomittee and I thank you for that effort. I'm glad that you will be with us. I know that you also have to leave on an 11:54 flight. I do hope, however, that you will be able to stay up until that flight so that you can, particularly from your capacity as a FCA board member, listen to the second panel made up of Federal Land Bank and Farm Credit local board people.

Now, evidently Jim Mullins isn't here yet, but I will introduce Jim to the rest of you anyway because I assume that he will be here soon. He is a member of the district board of directors for Omaha. Mr. Mullins is a farmer from Corwith, IA, and he represents the PCA's at the district level. But it's my understanding that from his position on the panel he will be able to comment on both Federal Land Bank policies and PCA policies.

Again, I thank both Mr. Mullins and Mr. Duncan for agreeing to be on the panel. So we will start with your testimony.

STATEMENTS OF A PANEL CONSISTING OF MARVIN DUNCAN, MEMBER, FARM CREDIT ADMINISTRATION, BOARD OF DIRECTORS; AND JIM MULLINS, MEMBER OF THE EIGHTH FARM CREDIT DISTRICT BOARD OF DIRECTORS FOR OMAHA, AND REPRESENTS THE PCA'S AT THE DISTRICT LEVEL

Mr. Duncan. Thank you, Mr. Senator. I am pleased to be able to attend this session this morning and to present testimony. I also welcome the opportunity to attend as much of this hearing as possible, because I regard it as an opportunity for me to learn from comments at the grassroots. And, as you are so well aware, Senator, it is always very helpful for those of us who have our workplace in Washington to get out and hear what comments and what views are being expressed in the heartland.

I want to visit with you this morning very briefly about the action that the FCA has taken to implement the Farm Credit Amendments Act of 1985 because in many respects those are initiatives that are helpful to Farm Credit System borrowers. I will also make some comments about the financial stress on the System and the interest rate issue.

The FCA has taken action to implement the 1985 amendments and for the most part those amendments are now fully implemented. We in the agency have placed great emphasis on financial reporting as part of that process because as you recall, Senator, one of the problems in dealing with the farm financial stress and the Farm Credit System stress during the 1985 amendment discussion was a lack of good solid financial information on System conditions.

So we in the agency have placed a great deal of emphasis on accurate and timely reporting to the Farm Credit Administration by the Farm Credit System institutions of their financial condition. I am pleased to report to you this morning that in our judgment there has been substantial improvement on the part of System institutions in their reporting procedures and practices.

I would hasten to add that there is still improvement that needs to be achieved, but I am heartened by the progress that has been made. The Farm Credit Administration has also pushed forward with an ambitious schedule of examining the institutions for safety and soundness. As you recall in the legislation, the System institutions will all come under the examination and regulatory authority of the Farm Credit Administration.

That has required a substantial increase in staff, and by the end of 1986 we anticipate having hired nearly 250 bank examiners to do that job. Many of the people we have hired are new college graduates. They are bright, articulate young people with good skills, but that presents a very large challenge to the agency in providing them the continuing training to give them the skills necessary to be fully qualified as bank examiners.

We have been working closely with the Office of the Comptroller of the Currency in putting in place such a training program. We also have hired some Comptroller of the Currency staff people to fill key positions in the Farm Credit Administration in the areas of examination and supervision. I should note that the Farm Credit System Capital Corporation, a central feature of the 1985 amendments, is now fully operational, and I anticipate it will be utilizing its assessment authorities in the not too distant future to raise assistance funds that it can use in providing assistance to more troubled institutions.

The Farm Credit Administration has taken an aggressive posture in putting in place regulations that deal with financial disclosure, borrower rights, and capital adequacy in System institutions. These institutions are cooperatively structured financial institutions owned by their borrowers and because of that we feel it is absolutely critical that those borrower-stockholders have accurate and timely information on the financial condition of the institutions from which they borrow and in which they are investors.

We believe that if that information is available these borrower stockholders will exercise their own good judgment in improving the management and operations of those institutions. As you recall, Senator, the 1985 amendments included a section on applicant rights. We feel that that is an excellent section and we have draft regulations out for comment currently to implement those.

We think that applicant rights of the type that were developed by the Congress are absolutely essential. This is particularly so when the institutions are owned by their borrowers.

We also have capital adequacy regulations out for comment and those are regulations that will address appropriate capitalization standards for system institutions. The intent of those is to over time build in greater financial strength into those institutions to permit them to bear risk better than they are currently able to do.

I might note that those institutions that meet capital adequacy standards will have full freedom to set their own interest rates. Only in the cases of those institutions that have seriously deficient capitalization positions will the agency be involved in reviewing financial plans for the institutions.

Let me comment on the condition of the system. I will do this briefly because I think that most people are aware of the financial numbers from the System. As you know, the system in the first 6 months of 1986 posted a $968 million loss. That compares to a full year's loss in 1985 of about $2.7 billion. The provision for loan losses in the System was raised in the second quarter of this year and that allowance now stands at almost $3.5 billion.

It is useful to note that the major reason for the losses incurred by the Farm Credit System has been the need to set aside substantial amounts in reserves for loan losses. System institutions still retain substantial financial strength. The total risk funds consisting of capital stock, surplus and the allowance for loan losses were $10.5 billion on June 30. That is down, however, from the $11.6 billion at December 31, 1985.

I would anticipate that the System will have another year of substantial losses this year. That is not at all inconsistent with what the agency, the Administration, and Treasury were telling the Congress last year during the discussion on the 1985 amendments. At that time, we expected the System to post substantial losses in 1985 and in 1986 and perhaps in 1987 as well.

Let me comment quickly with regard to interest rates. In response to the borrower flight and competitive forces in the affected System lenders, the Farm Credit Administration has allowed the System a prudent level of interest rate relief. The FCA's July approval of 50 basis points or one-half percentage point in interest rate reductions for each district cost the system some $200 million on an annual basis and that is $200 million of the earned equity in the system.

As of mid-August, the FCA has approved one or more interest rate proposals submitted by each of the 12 districts and FCA stands ready to approve additional rate reductions as the districts' debt cost decline and as the financial condition of the institutions allow. The system faces a particularly difficult problem in that their cost of funds is quite high.

The system grew rapidly in the late 1970's and early 1980's, and they borrowed in the capital markets to support that growth, in many instances borrowing long term. The result is that the system still has $21 billion of very expensive debt issued in the late 1970's, and the Federal land banks are locked in at about 11-percent interest rate payments, on average, on these securities.

Now, some of those securities don't mature until just after the turn of the century. Many of those high-priced securities will be rolled over during the next 3 years.

Another very difficult situation for the system is that it has almost $8 billion of nonaccrual loans or loans on which no payments are being made. This suggests that importance of restructuring those loans if they are restructurable so they can once again become earning assets. With that let me close my prepared remarks, Senator, and respond to questions that you might have.

Senator GRASSLEY. OK. I'm going to ask Jim to testify first. Jim, I introduced you except for saying that you're probably famous because your wife's a good State legislator more so than because you're a good farmer or farm leader. But you're all of those things as well as the husband of Sue. I would ask you to go ahead and then also I think my staff asked if you could summarize, you know, maybe 6, 7 minutes.

Mr. MULLINS. OK.

Senator GRASSLEY. So we've got time for questions because I have got lots of questions.

Mr. MULLINS. Fine, Senator. Thank you very much and I apologize for being a little bit late.

Senator GRASSLEY. You weren't late. I started early.

Mr. MULLINS. It was a long drive down this morning. I thought I could have been a little late. But I do have with me also Tom Stinson who is the vice president for regional operations for Iowa, so that if we get into questions of a technical nature, those with the exact figures. I have someone to rely on.

But I am Jim Mullins, a farmer from Corwith, IA, and a member of the Eighth Farm Credit District board of directors. And today I am testifying in place of John Harling, CEO of the Farm Credit Banks of Omaha. I do appreciate, Senator, this opportunity to testify because I feel there are some definite actions that Congress can take to assure that agriculture continues to have a supply of credit on a dependable and competitive basis.

During my testimony today I will try to list some of those which we believe are needed, the reasons for the need and the consequences if their is not action on the part of Congress.

In the letter of invitation, Senator, you emphasized the need to assure that credit is available for farmers this spring. I believe that the problems that agriculture faces go beyond just the need of credit in the coming spring. They embody the very ability of all farmers to stay in business. They affect all institutions which provide services to agriculture. They affect the entire fiber of mid-America and I believe will soon affect our Nation's economy to a greater degree than many people had previously thought.

Many of our Eighth Farm Credit District directors and officers have stated repeatedly over the years, the past 2 years especially, that agriculture's problems primarily come down to a lack of profitability. Unprofitability is the end result. It has been brought about by a scenario which unfolded with Government budget deficits, a strong dollar against world currencies, dwindling foreign markets, commodity surpluses, low commodity prices, high interest rates, negative cash flows, declining land values and inability to handle debt obligations and a lack of viable loan restructuring alternatives and finally foreclosure. So the scenario unfolded this past couple years.

The result has been business failures for many farmers, ranchers, and also institutions that serve them. And if we do not find the right solutions there will be many more failures. Let me say up front there is no one solution to the problem. There is not that silver bullet that the Lone Ranger carried for many years, but there are many, many various solutions that need to fit together in like a jigsaw puzzle to solve this complicated problem.

The farmer-owned Farm Credit System has been attempting to do what will help individual borrowers while simultaneously attempting to protect the interest of those same borrowers as a group. We have cut costs. We are continuing to look for ways to make our operations more streamlined and more efficient. We have developed programs to assist those borrowers having financial difficulties primarily by deeply exploring every workout alternative before foreclosure is pursued.

We have developed new interest rate programs based on the level of risk in individual loans which has permitted us to get our interest rates down to somewhat competitive levels while serving all borrowers equitably.

We are revitalizing our efforts to utilize the FmHA Loan Guarantee Program. I have attached to this testimony, Senator, a letter that we sent to Frank Naylor, who is chairman of the FCA board, pointing out some of the things that we have done in the Omaha Farm Credit District over the last year to improve our operations and to better serve our borrowers. I have also attached some information summarizing our loan restructuring activities. I would like those inserted as part of the testimony if they could be so.

Senator **GRASSLEY**. Yes. That's automatically granted.

Mr. **MULLINS**. OK. Thank you. One of our problems is that in many instances our hands are tied by well-meant legislation which ends up costing our borrowers more and it also impacts availability of credit. One of our primary handicaps is a provision that the Farm Credit Administration must approve all interest rate changes. I know of no other business where the basic right of product pricing is not in the hands of directors and officers.

I mentioned that we had developed new individual pricing programs for the Land Bank and PCA, yet there are additional loan products, loan pricing techniques which are needed and which would help slow down the devaluation of agricultural land and assist our members.

Some Members of Congress have recognized this legislative problem and currently Senator Cochran has proposed a bill, I believe it's Senate bill 2770, which would put the right of product pricing where it belongs, with each Farm Credit district. Some Members of Congress have proposed increasing the FmHA direct and guaranteed loan programs, both ownership and operating by the way.

With these types of business initiatives there would be little need for a secondary market which some have recently promoted. Without congressional action addressing the right of district boards to price Farm Credit loans, we will be hamstrung in our efforts to develop new products and have competitive loan pricing. It will be costly to both farmers and the system alike.

There are other examples of legislation which adversely affects the way loans are made and serviced. Legislation which artificially changes the loan contract may temporarily help a few distressed farmers but ends up raising interest rates for other borrowers. An example is a law in Nebraska, LB999, which exempts the homestead and 160 acres from foreclosure in some cases. The law was supposed to assist those farmers, Senator, in repurchasing their homestead. It has resulted, however, in the curtailment of credit to distressed and smaller farmers.

We also see various legislative attempts to change the way lenders can collect on a loan after it has been made. Such laws when they delay the collection ability of deficiency judgment liberalizing the bankruptcy laws are unfair to both borrowers who are working hard to remain current on their loans. I does allow a small number of borrowers, however, to avoid their contractual obligation at the expense of the other borrowers who are paying their way.

I realize that legislation of this type comes from a desire to help farmers who are suffering under the restructuring of agriculture. I also realize that it's easy to point to an institution and say, "You're the bad guy." But if legislation of this action is not curtailed, it will hinder us from working with those borrowers who have a chance to survive.

The Farm Credit System itself is worried about survival. It becomes more and more evident every day that the system will have to request financial assistance from Congress. We have feared that extended congressional debate will take place when that request is made. Research and planning must take place now so that help is in place in time to save the system and its members when it is needed.

The consequence of delay or inaction to save the Farm Credit System will spell disaster. I cannot believe that any other instituton would or stands ready to step in on any kind of timely basis and fill that vast void that would be left if the Farm Credit System does fail.

We know of the difficulty that many farmers have finding financing when a commercial bank fails where they are now borrowing. I shudder to think of the havoc created if the entire farm—or if a Farm Credit bank were to fail.

Let's turn for a moment to that original question, will there be credit available for farmers? The answer is there will be ample credit for farmers if a few things are caused to happen, three of them. The first one of those is a thing that the Farm Credit System we feel strongly should be allowed to price its own product and develop those kinds of products that they can merchandise and market. Also Government entities should permit lenders to continue to make and collect loans in a businesslike and an equitable manner. And third, Congress should prepare for standby appropriations for the Farm Credit System when such assistance is needed. And that action and planning should start now.

In conclusion I believe that we at Farm Credit banks are striving diligently to address the current agriculture crisis in a constructive and an equitable manner. It is my hope that Congress and State legislators will approach the various solutions with equal care. I thank you for this opportunity, Senator.

Senator **Grassley**. Thank you. And I appreciate particularly both of you summarizing your statements. I'm going to have as I indicated lots of questions and I think it would be fair for me and candid for me to say that these questions don't necessarily originate from my office but originate from my office having been contacted by a lot of Farm Credit borrowers and questions that we were asked, although I would not preclude the fact that there are questions in here that I want to ask as well.

One question that I did not anticipate asking but I'm reminded of by Mr. Duncan's statement about the high-priced bonds that have a penalty, is there an escape clause to get out from under those?

Mr. **Duncan**. Senator, the bonds that are out there are fixed-term instruments. There is not an early recall provision. There is not a penalty as such for prepayment except for the penalty that would ensure from having to go into the marketplace and buy those bonds back. In the current interest rate environment, that penalty would probably be quite steep.

Senator **Grassley**. Does any one district have a significant high pecentage of those high-priced bonds?

Mr. **Duncan**. The predominance of high-priced money as you might suspect is among those institutions that were growing most rapidly in the late 1970's and early 1980's and that certainly includes the Omaha Farm Credit Banks. The land banks generally have high-priced debt and debt of longer maturity than do the Federal intermediate credit banks and the banks for cooperatives.

Senator **Grassley**. Does your agency look for heavy reliance upon these high-priced bonds with a penalty and that are locked in for a long period of time as poor judgment, especially to use such a high percentage of them without an escape clause?

Mr. **Duncan**. There was discussion long before I came to the agency about whether or not to have a recall provision in those bonds. It was not done because of the concern that it would add substantially to the cost of those bonds. In retrospect, perhaps that possibility should have been considered somewhat further. As a rule, if you have a recall provision in those instruments there will be a significant cost to the system as a result. The system bet on continued growth in its outstandings and continued very low real interest rates and unfortunately, that was wrong.

Senator **Grassley**. Mr. Duncan, when does the Farm Credit System expect to come to the Government for assistance?

Mr. **Duncan**. I don't know when they expect to come to the Government for assistance. They have not at this point told us. I'm reminded, in looking at their financials, that they still have substantial financial resilience. I'm reminded as well, that a key feature of the 1985 amendments was the capital corporation which was to be the workout bank for the system and to be the self-help mechanism. That capital corporation got off to a slow start in our judgment. It took most of the summer to get fully operational even though it had its first meeting on April eleventh. It is now fully operational and it seems to us important that that capital corporation have an opportunity to demonstrate its ability to play a constructive role in self-help in dealing with the system's problems.

Senator GRASSLEY. Mr. Mullins, when does Omaha run out of money?

Mr. MULLINS. The Federal Land Bank of Omaha has already obviously run out of money. They have—I cannot remember the exact figure—that was last year. I think to date we're over $300 million that has been pumped into the Omaha Land Bank from other districts.

Mr. DUNCAN. Senator, both the land bank and the intermediate credit bank at Omaha are receiving or will receive assistance from other system institutions.

Senator GRASSLEY. The federal——

Mr. MULLINS. The Federal intermediate credit bank did receive help a year ago. The Federal intermediate credit bank of Omaha also at the end of the first half put another $9 million back into the system for financial help.

Senator GRASSLEY. What we're trying to find out here is how long can the rest of the system continue to support districts that need help like Omaha without coming to the Federal Government for assistance.

Mr. DUNCAN. I think it is fair to say, Senator, that there needs to be no concern about 1986. Beyond that one gets into an area that is quite conjectural.

Senator GRASSLEY. There are 4 months in 1986. Can we look at 12 months? Is it going to happen in the next 12 months?

Mr. DUNCAN. I don't think it needs to happen in the next 12 months.

Senator GRASSLEY. It doesn't need to happen in the next 12 months?

Mr. DUNCAN. When I say that I'm assuming that the capital corporation can play the constructive role that the Congress had in mind for it.

Senator GRASSLEY. Mr. Mullins.

Mr. MULLINS. Yes. You know, I would not argue with Mr. Duncan. He is much more intelligent about the figures than I am. I'm a lay individual, a farmer who sets policy. However, when I look at those funds that are available as risk funds, and according to my understanding of the amendments we are insulating capital stock by the borrowers, that we then have $2.4 billion left for reserve. I'm rounding some of those figures. Of that $2.4 billion is about $1.2 billion that's tied up by the PCA's of this country.

Now, we are all aware of a PCA that has instigated action to tie that up. There was a very favorable action from my standpoint, my view by FCA along that that said no, that has to be a part of those system funds. I don't know if that's the final answer, but my concern is that if somehow through litigation that $1.2 million in tied up, we have lost another share very quickly. I have a concern from that standpoint.

Senator GRASSLEY. Do you think it will be in the next 12 months?

Mr. MULLINS. From a very personal standpoint, I do.

Senator GRASSLEY. Mr. Duncan, what are the ways that the system can get back on its feet without coming to the Treasury to borrow?

Mr. DUNCAN. I come back to the Farm Credit System Capital Corporation. If that capital corporation can be very judicious in its use of assistance to institutions, if in return for assistance the capital corporation can effect management changes and policy changes in institutions that are having problems such that the performance of those institutions will improve, if the capital corporation can be effective as a workout bank for the system turning those nonaccurals around and turning them back into accruing assets, the capital corporation can be—will be a very, very important part of system self-help.

Senator GRASSLEY. Beyond the capital corporation?

Mr. DUNCAN. There are $3.5 billion of loss reserves in the system and that's sometimes overlooked when one hears about declining earned equity. The earned equity, in large measure, is declining because it's being shifted from one account to another account. It's being shifted to the loss reserve account.

So by and large those funds are still there. They are set aside for risk that appeared to be in the portfolio at the time that the determination was made. I note finally that if the conditions in agriculture improve, that can have a very marked impact on the circumstances in the system. I frankly feel that conditions in agriculture could improve somewhat. I think in Iowa, for example, that one is probably fairly close to the point at which land values will stabilize.

Senator GRASSLEY. I hope you're right, but 6 months ago I would have said things would be turning around now and, you know, it doesn't look as good today as it did 6 months ago from my standpoint. But I hope you're right.

Sometimes we hear these suggestions used in the system, No. 1, using the system as a secondary market for bad agricultural loans, using the system's agency status to give commercial lenders access to cheap money, demanding more good collateral, the system purchasing Government loans such as water and sewage loans and community service loans, selling strong access such as land and merging into larger districts. You only talked about the capital corporation, so you aren't suggesting these things?

Mr. DUNCAN. No. I would not discount many of those possibilities. Each of those under certain circumstances could play a part in the solution.

Senator GRASSLEY. Then I think that leads me to another question of whether or not these proposals push the opposite direction of its goal and mission of serving the family farmer.

Mr. DUNCAN. No, I don't think so. Most of the suggestions that you have made are not——

Senator GRASSLEY. Now, wait a minute. I didn't make these suggestions. I'm saying that we hear these.

Mr. DUNCAN. I understand, sir. Most of those are not inconsistent, I think, with serving family farmers. For example, if the system were to be able to purchase from the Government the sewer and water portfolio of the FmHA and fund it with new debt such that it could lock in a favorable spread, the system would generate additional earnings.

Senator GRASSLEY. As a grassroots policymaker, Mr. Mullins, what do you think about some of those suggestions?

Mr. MULLINS. If you're trying to talk about general restructuring of the whole Farm Credit System, I think that's one alternative that needs to be looked at, needs to be investigated. I do have concerns—

Senator **Grassley**. But you haven't made up your mind if that's the direction to go?

Mr. **Mullins**. From the standpoint of looking at the availability of moving capital within the system, that's a very plus. A negative is how are we going to maintain a viable source of input by directors in control of the system? I don't think it's impossible, but I think one needs to be very aware of those concerns.

Mr. **Duncan**. Senator, I might note that I share Mr. Mullins' concern about grassroots control and farmer control of the system. In fact, Frank Naylor and I have recently sent out to the system institutions a letter indicating a policy position we have taken with regard to mergers within the system. And in that policy paper we have indicated that the agency is not going to be a driving force in that merger activity; that if there are mergers presented to the agency for approval, we will look at each one on its merits, but those will have to be generated on the basis of borrower stockholder interest.

Senator **Grassley**. Mr. Duncan, isn't it possible that the system itself has helped to cause a significant amount of the problems that we have in rural America by three points? One, forcing too much land on the market through both selling acquired property and forcing farmers to sell, two, having too high of interest rates which directly relates to the dropping land values when they are capitalized back into the value of land. And there, commercial lenders seem to get away with having high interest rates also because of the lack of competition.

We just recently read about this in the Federal Reserve Board report which suggested that one reason why interest rates on commercial banks might be higher in Iowa than in States around Iowa is lack of competition. And also, of course, the system is withdrawing from lending thereby having the opposite effect that it did in the 1970's when they helped to force land values up through aggressive lending policies.

Wouldn't it be advisable to reverse the trend by lowering interest rates aggressively lending to farmers and helping farmers to stay on their land?

Mr. **Duncan**. Again, I think that the restructuring of farmer loans wherever that is possible is a thoroughly constructive approach to dealing with this problem. The system—as I indicated earlier in my earlier testimony—will be incurring losses this year so that one must remember any reduction in interest rates below or beyond the reduction in cost of funds to the system will come out of the capital. It will eat into the capital position of the system and will bring it more quickly to the point at which it would need public assistance.

Senator **Grassley**. Will there by any more interest rate reductions in the near future?

Mr. **Duncan**. We are quite prepared to look at additional interest rate reductions as the district's debt costs decline and as the financial condition of the institutions permit. With the declines in money market interest rates, we certainly are going to be looking at what that is doing for the system debt costs.

Senator **Grassley**. Did the FCA tell the districts to implement their tier structure of interest rates?

Mr. **Duncan**. We did not tell them to. The FCA and the system institutions in many instances both felt that a tiered system was a way to deal more effectively with the system's loss of borrower problem. And also that system of pricing loans based on the risk of those loans hold to the lender is a system that is almost universally applied across all lenders.

Senator **Grassley**. Does that mean you judge districts on what they did to keep good customers when it comes time to consider that district for future interest breaks?

Mr. **Duncan**. We will be looking at a number of factors when system institutions come back to us and ask for further interest rate reductions. We will be looking at the——

Senator **Grassley**. Did I characterize it wrong in my statement about whether or not you're going to judge a district on what they do to keep good customers?

Mr. **Duncan**. We are clearly going to be looking at how effectively they have dealt with their borrower relations problems, how effective they have been with dealing with borrower flight, and how effective they have been dealing with other problems in their institutions.

Senator **Grassley**. Well, then I guess I need to have you define for the Congress what keeping good customers means because that's the judgment that you have got to make. You're telling these districts——

Mr. **Duncan**. That is a judgment and that's a qualitative judgment, Senator, and that's the reason I don't want to leave the impression that is the only consideration we would be looking at. It is a qualitative judgment.

Senator **Grassley**. To what extent is it a criteria? Is it 50 percent, 75 percent?

Mr. **Duncan**. We have not yet made that judgment. Dealing with borrower relations, the improvement in management practices in system institutions and procedures in system institutions and the reduction in debt costs to those system institutions will clearly be more important than the other factors.

Senator **Grassley**. Let me say it this way then. It seems to me that there would be two ways to help the portfolio, one, to keep good customers and, two, to get poor customers in better condition. Would it be possible that by going after the first part of the formula, keeping good customers, that we're going to cause problems for ourselves in the second part by putting the poor customers in a worse condition?

Mr. **Duncan**. If the system is able to keep its better customers, if it is possible for it to turn around its decline in loans outstanding if it is able to roll off its high cost debt and replace that with lower cost debt, I think that will be a benefit to all borrowers of the institutions.

Senator **Grassley**. I would like to have you tell me what I hope will be a negative answer to the rumor that Farm Credit Administration is proposing merging the 12 banks into 6 or 8 banks.

Mr. **Duncan**. We have heard the same rumors and that was——

Senator **Grassley**. So they are rumors.

Mr. DUNCAN. There are rumors that the system institutions are talking about a grand merger. That was one of the reasons we sent that policy letter out. We wanted that letter in the hands of all the institutions before they had their national directors conference to be sure that there are no misunderstandings in the system as to where the Farm Credit Administration Board stands. We are not in the business of forcing mergers or pressuring for mergers.

Senator GRASSLEY. Mr. Mullins, do you favor supporting mergers into 4 or 6 districts?

Mr. MULLINS. From the information we have so far I can't say yes and I can't say no, but we do need to study this as a system, Senator, and it's one of those things that directors need to say yes or no to. I mean, if directors who are elected to represent those member borrowers decide they want to do it, that's fine. But that's where that movement has to come from or from members and directors.

Senator GRASSLEY. If that decision is made, is that going to be done by local directors or by the district directors?

Mr. MULLINS. When any entity is merged, those stockholders of that entity are the ones that have to vote. So anytime local associations are merged, those stockholders of those local associations are the ones that vote. If you are going to merge—correct me if I am wrong here, if you are going to merge district banks, then the stockholders of those banks are the ones that vote and those stockholders of the banks are the associations within that bank.

Senator GRASSLEY. Mr. Duncan, when is the third FCA board member going to be appointed and why hasn't he or she been appointed yet?

Mr. DUNCAN. Senator, I don't know when the third member will be appointed. I have heard nothing of an official nature as to an appointment. I do know that the clearance process takes a long time. Beyond that I know no more in that regard than you do, sir.

Senator GRASSLEY. Well, with my relationship with the White House you wouldn't expect me to have an answer. Mr. Duncan, I have heard that the FCA has a new policy which limits access to Farm Credit Administration employees during what we call the comment periods on regulations issued by the FCA. Now, I'm concerned about such a policy since it seems to be counter to the purpose of comment periods. Is there any truth to this and what are you going to do to ensure proper input with such a policy?

Mr. DUNCAN. What you have heard is an incorrect assertion.

Senator GRASSLEY. OK. Let's let it go at that then.

Mr. DUNCAN. If I may, let me expand on this. We operate under the Administrative Procedures Act when we develop regulations they go out for public comment and they are available for public comment from everyone on an equal basis. We welcome full and complete comment from system employees, from system management, from farmer directors of those institutions. We are forthright in our desire for full comment.

What we have not done is to sit in a closed room with a few people from the system and negotiate regulations. That is a violation of the law and we have not done that. We have instead provided a full, complete and free and open comment period on regulations. And believe me, Senator, we take every one of those comments very seriously and the disposition of each of those comments is dealt with in the preamble to the final regulations that are considered by the board.

Senator **Grassley**. Mr. Mullins, there are some very specific figures that I would like to have. What is the present loan volume of the PCA's? And I would like to know how that relates to last year and I would like to have that both in number and percent of drop and then for an average year. I will let you pick the average year.

Mr. **Mullins**. PCA current loan volume total, this is accrual and nonaccrual and this as of the 30th of June, is $707 million. That's in the PCA's. Federal Land Bank total accrual and nonaccrual $4.8 billion a year ago.

Senator **Grassley**. OK. How does that relate to last year?

Mr. **Mullins**. It's going to be lower, but I'm having to find the figure, what it was a year ago.

Senator **Grassley**. I think we can have you submit that for the record.

Mr. **Mullins**. The first figures I gave you I did submit. That's already in there.

Senator **Grassley**. How many new Federal Land Bank loans have been made in the last 6 months excluding acquired property loans?

Mr. **Mullins**. New loans, Federal Land Bank associations in Iowa there were 80 and—no, wait a minute. And in the district as a whole 239, but 80 in the State of Iowa.

Senator **Grassley**. That's excluding acquired property loans?

Mr. **Mullins**. That's correct. That's Land Bank.

Senator **Grassley**. Yes. That's the question I asked. Mr. Mullins, it has been reported that Omaha no longer has the authority to carry out its own policies but instead they must report to the FCA and other top Farm Credit System officials. Is this the case?

Mr. **Mullins**. Well, I'm not sure I understand your question entirely. But there are many actions that we as a district when we take those actions have to have the approval of. It is subject to the approval of the Farm Credit Administration, it is subject to the approval of the capital corporation and also subject to the approval of the Joint Finance Subcommittee which is a committee of the land bank, district land banks.

Senator **Grassley**. I have some questions, Mr. Mullins, on the tier structure for interest rates. What is the new tier interest structure and how will these loans be evaluated?

Mr. **Mullins**. Now, is this for the—are you talking about the land bank or PCA?

Senator **Grassley**. Land bank.

Mr. **Mullins**. Land bank?

Senator **Grassley**. Yes.

Mr. **Mullins**. I will have to find those exact figures.

Senator **Grassley**. I also need to know from you how many farmers, both as a percentage and a number, will fall into each category.

Mr. **Mullins**. As far as how many are going to fall into each category, we won't know that specifically until we get their applications in. And those applications for reduced interest rates under the land bank tiered structure are coming in now. As a matter of fact, they're coming in fairly rapidly, so we won't know for sure what they are.

But we have the AAA classification, which is the lowest classification at 10.5, the AA at 11.25, the A classification 12.25 and the B classification 12.75 which is the current rate. Also we still maintain the default rate which is 2 percent for that portion of the loan which is in default.

Senator **Grassley**. Would you have a target of the percentage of farmers that you would expect or want to fall into each category?

Mr. **Mullins**. I can only tell you this. It was a nonstatistical survey that we put together when it was brought to us as a board and we looked at it and we were getting—and I'm talking about numbers now. It was roughly equal in those four classifications. Now, that's numbers of farmers. This was not statistically accurate. You know, it was just something for some information. See, we don't know until everybody applies so we know where their loan falls in the classification.

Senator **Grassley**. Well, maybe you can't be specific on the statistics, but I think what we need out of a hearing like this is to know how things will be evaluated. Now, we have heard terms like: owner equity, payment record, current intermediate credit positions, and security positions. What we need to know for this hearing is, what are each of these variables worth in the formula that determines where you're going to end up?

Mr. **Mullins**. OK. I'm with you now, Senator, The restructuring is determined on risk factors. First, as you pointed out, owner equity, that's worth 20 points. Current intermediate positions, you know, intermediate position, short-term debt and assets, that's worth 10 points, payment history 5 points, security position 15. That would make a total of 50 points that you have, the highest of each one of those particular risk factors.

Senator **Grassley**. What's the security position?

Mr. **Mullins**. 15.

Senator **Grassley**. Where is the break then? In other words, at how many points does it take to be in the 10½ percent and then where do you go into the 11?

Mr. **Mullins**. In the AAA rate which was the 10½, the lowest rate, point value is 41 to 50, AA rate 31 to 40, A rate 21 to 30, the B rate zero to 20 and then as I mentioned before the default.

Senator **Grassley**. The only thing I would ask, and I'm not sure because this is off the top of my head, but I notice a low percentage for payment record. Now, by golly, suppose you have never missed a payment, always been there on time, even a little bit early. You know, you never have any reason to think this guy isn't going to be just as honest as ever and keep it right up. Why is that such a low factor.

Mr. **Mullins**. I can't answer for sure why it's so low. There are—as we have discussed these, we don't all agree 100 percent even with us as a board when we vote on the things on how they come down, but probably our experiences in the last few years is without the equity and without the security position, the history itself, if you don't have those two things available the payment is not going to be there.

Senator GRASSLEY. Let me ask you this from the standpoint of board consideration. You said the board made these decisions and there's honest differences of opinion within the board. I assume that the administrative staff made a recommendation to you. How do these weights as finally determined, 20, 5, 10, and 15, differ from what was originally proposed to you by the administrative staff or was it an endorsement of a staff proposal as you recall the debate?

Mr. MULLINS. This was the second proposal.

Senator GRASSLEY. So that means that the board originally rejected the first proposal?

Mr. MULLINS. I think it was a change that came from staff within themselves as we talked about it. But anyhow, the owner equity and the security positions changed.

Senator GRASSLEY. I think you have been very helpful on that point, not only for the benefit of this subcommittee but for the benefit of farmers.

Mr. MULLINS. If there are any questions, Senator, this is what the board as a whole adopted.

Senator GRASSLEY. No, I don't. I just wondered. I just was following up to determine the extent to which board input maybe changed staff recommendations. But that's not my key point anyway. What would happen once you made a determination if somebody was going to be at 10½ percent, what stops you from later on raising everyone's interest rate back up again after they have gone through this process?

Mr. MULLINS. I guess there's nothing that stops one from changing interest rates.

Senator GRASSLEY. Is there any guarantee once the people go through this process of getting into a lower interest rate that the rates aren't going to go back up there then? I guess you're telling me there isn't any guarantee.

Mr. MULLINS. There isn't as long as we have as part of our loan package a variable interest rate structure.

Senator GRASSLEY. Also, Jim, I would like to ask a general comment on what you think this program of tier structure does to the system's public image. And I want to say I have been called by several farmers who are upset because they had a verbal agreement at the time they signed their loan that they would benefit from any interest rate reduction and now, of course, you're not only telling them that they don't but you're going to in a sense force them to send in a lot of information every year. I just wonder if you see that that has a negative impact on the credibility of the system.

Mr. MULLINS. Well, I will have to agree up front that I think it has a negative impact on the image of the system. You know, we're operating within the——

Senator GRASSLEY. Is it good for the system? Do you think it's good for the system?

Mr. MULLINS. I think long term for what we are trying to accomplish, Senator, I think it is. Short term as far as the image of the system it does not improve that, but I do think it can do two or three of the basic things that we are trying to accomplish when we look at setting policy in the direction we're going to do.

You know, there's three things that we as farmers need. One is profit, one of them is somehow if we could have at least a stability or even hopefully a rise in collateral values and, third, lower interest rates. It seems to me that when we look at making these kinds of decisions, we can't do too much about the profit structure, any lender, but if we can do something that will help collateral values, I think that helps everybody. That's the point we kind of come from and look at when we make those decisions.

Senator GRASSLEY. Isn't it pitting troubled farmers against wealthy farmers?

Mr. MULLINS. I think one can take a viewpoint and say that's part of it. But I also think, Senator, that if we can keep those good borrowers with the system who have the ability and the flexibility to move anywhere because they are in good enough shape. If we can't get interest rates down low enough to keep them within the system, then that's going to penalize everybody else. So in the longer run I think it actually can help them. But I agree with you that in the short run the image is not good. It's not easy to sit and say, "Let's do that." That's not a very popular thing to do.

Senator GRASSLEY. Now, within this one-half interest rate drop that you have to operate as you put this into motion, what are you going to do if after all of this you don't use up that full one-half percentage drop that the FCA has allowed districtwide? Would you go through and lower everyone's interest rates or would you buck another group of borrowers into the lower interest brackets or would you just simply do nothing?

Mr. MULLINS. First of all we have used up the whole thing as far as we can tell in our anticipation. I mean——

Senator GRASSLEY. Suppose that doesn't happen.

Mr. MULLINS. Yes, if it doesn't happen because of when they come in again—let me back up and answer it the other way. Our first proposal was for a higher than one-half of one percent. At that time we weren't aware of this policy that came along after that. So then it's speculation on my part where we would go, but my guess is we would discuss perhaps lowering every single interest rate a similar amount in order to utilize that one-half of one percent. That's one possibility.

Another possibility we're also looking at are different kinds of marketing tools, different kinds of land loans in order to encourage the purchase of land and to stabilize those land values. They would all have to fit. All of those programs in my understanding would have to fit within those guidelines.

Senator GRASSLEY. A little more specific question. Why isn't a farmer given credit for crops in the field right now, you know, so darn close to harvest and particularly if that farmer has crop insurance on his crop?

Mr. MULLINS. I can't tell you what exact date that happens. I know that at certain times up to a certain point we don't, after that we do. I don't know what that date is. I don't know. Let me see.

Senator GRASSLEY. OK.

Mr. MULLINS. My understanding is that if that farmer who has crop hail insurance or Federal crop insurance, if he notes that on his ballot sheet, then that amount would be credited back to his balance sheet. So maybe they need to be encouraged to do that.

Senator **Grassley**. All I can say, you're causing this farmer a heck of a lot of problems if I want a lower interest rate. What steps are being taken to reamortize loans versus foreclosures?

Mr. **Mullins**. We have—I don't have the policy. There are four things that we look at. The things that we look at are the deed in lieu of debt, the set-aside provision. I was looking for the policy, Senator. Just a minute.

Senator **Grassley**. What your answer is then the policy statement that——

Mr. **Mullins**. That would be the answer of what we're doing, Senator. Are you aware—you have that policy?

Senator **Grassley**. I would like to have you submit it for the record just so that we know we have it up to date. How many Federal Land Bank loans have been reamortized? And I'm not talking about deferrals and I don't want to know about loan servicing actions. I want to know how many farm Federal Land Bank loans have been reamortized.

Mr. **Mullins**. The figure that I have is a figure that includes restructuring reamortization and principal amount deferred and amount formally extended. I have got that in Iowa or the district.

Senator **Grassley**. That's not exactly what I want, so then let's ask you to submit for the record my response to that question.

Mr. **Mullins**. Could you state that again?

Senator **Grassley**. How many Federal Land Bank loans have been reamortized? And we don't want included in that those that have been deferred and we don't want the category called loan servicing actions. Next if you could give me in some detail what exact procedures will be used to implement forbearance regulations issued by the FCA. For instance, the regulations that require the system to restructure when foreclosure is more expensive and——

Mr. **Mullins**. So you want more than our policy on forbearance is what you're telling me?

Senator **Grassley**. Yes. You know, kind of the procedure you go through to make sure that the spirit of the——

Mr. **Mullins**. Of the policy is implemented.

Senator **Grassley**. Yes. For instance, the system is supposed to have sent out teams to train everyone on the staff about these new forbearance policies and quite frankly to us it doesn't look like much has been done in this area. So if you're doing something in this area, let us know.

Mr. **Mullins**. Senator, if it's all right, I'm going to ask a staff person to give that because all we're going to establish is the policy and he's going to tell how we implement that policy. He is vice president in charge of regional operations for Iowa.

Senator **Grassley**. While Mr. Stinson is responding I would ask Mr. Duncan to think in terms of what is your agency doing to see that the new regulations are being followed, but don't answer that. Wait until he responds.

Mr. **Stinson**. Senator, under the policy that Jim alluded to, one of which is forbearance, the other one that the district board has approved is a compromise of indebtedness policy. From a banking standpoint any restructuring involves a compromise of indebtedness, either a forgiveness of past accrual of interest or principal or anticipated accrual of either. Under those policies, procedures were developed and communicated to all loan officers and they were done so in Omaha in June as part of a training session. And they have an understanding of what flexibilities there are within our policies and procedures.

Senator GRASSLEY. You have answered our question. Mr. Duncan?

Mr. DUNCAN. Senator, when our examiners go out to Farm Credit System institutions to conduct examinations, part of their examination will be to determine whether the institution has in place policies and procedures for implementing the applicant rights language in the law and in the regulations and the extent to which those institutions indeed are implementing those policies and procedures.

Senator GRASSLEY. Mr. Mullins, what exactly is the current policy and procedure regarding delinquent loans and the steps that are taken toward foreclosure? For instance, has it changed from the point where you used to wait 30 days before you would start any action? We have heard of instances where they start contacting within 10 days and 20 days and at 20 days start foreclosure action by filing for mediation, file for the right to cure and other such actions.

Mr. MULLINS. Our policy on forbearance and those has not changed since we adopted these in the first part of this year, so I'm not sure I am really understanding what you're referring to.

Senator GRASSLEY. Do you start foreclosure before 30 days? That's the key point that we want an answer to.

Mr. MULLINS. Generally we do not. The scenario and the time frame—with the advent of mediation here in the State of Iowa we work the right to cure under the law as a request for mediation which would typically occur in the 60-day window, the 60th day on or about, after repeated efforts to contact with member and work through his plan.

Senator GRASSLEY. So then there isn't any action started before 30 days?

Mr. STINSON. Typically 60 days. Occasionally there is an action begun within 30 days that would result from an ongoing discussion with that borrower. And Jim has a forbearance policy here. We can enter it into the record. But it states that if the member is not cooperative or unwilling to present a plan or in the interest of all stockholders as a group we need to accelerate the loan to protect the right of those stockholders and will do so. So occasionally there is one under 30 days.

Senator GRASSLEY. How do you find out in 30 days if they aren't cooperative if you haven't contacted them for 30 days, I mean, if as you say you wait until 30 days have elapsed before you start anything?

Mr. STINSON. I misspoke if that's what the understanding was. We do not wait 30 days to contact the member. The initial contact is between the 8th and the 12th day and there's a reminder notice of his Land Bank installment being late. Therein begins a frequent contact to attempt to get together with the member and obtain his plan. So we begin that by no longer than the 15th of the first month following default.

Occasionally a member will come in prior to his payment date and offer information or may apply for a land bank loan or loan service in action which gives us the information. And working through the dialog with the member we come to that realization that there's no ability on our part to forbear under the policy.

Senator GRASSLEY. Mr. Mullins, why do you charge a default interest rate penalty of 2 percent on farmers who are still actually trying to make their payments?

Mr. MULLINS. That has been established in the policy only for that amount then also that is in default, not the entire loan.

Senator GRASSLEY. Well, you know, other lenders have the option of doing that as well and very seldom do they ever exercise it. So what is the reason that the Farm Credit System is exercising it?

Mr. MULLINS. The delay in payment and the further—I want to say delay in interest receivable.

Senator GRASSLEY. Let me ask you this. Wouldn't this policy be helping to ensure that you aren't going to get paid and that it's going to help put the farmer out of business faster?

Mr. MULLINS. It will be a negative influence on his coat structure, you're right.

Senator GRASSLEY. I think I'm done with my questioning. I ask Mr. Duncan, would you be able to stay part of the time?

Mr. DUNCAN. Senator, I will be happy to stay until about 10:30 or slightly after that and then I will have to leave to catch an airplane.

Senator GRASSLEY. Also, if we could have the people from Omaha stay at least I would like to have them hear the next panel as well. Also for the benefit of anybody on the local boards or the next panel that wants Mr. Duncan to hear your point of view, I would urge you to express that very early in your testimony. Thanks to each of you. I appreciate it very much. You have been very cooperative.

Mr. DUNCAN. Thank you, Senator.

Mr. MULLINS. Thank you.

[Prepared statement and material follow:]

PREPARED STATEMENT OF JAMES A. MULLINS

I am Jim Mullins, a farmer from Corwith, Iowa and a member of the Eighth Farm Credit District Board of Directors. I am testifying today in place of John A. Harling, president and chief executive officer of the Farm Credit Banks of Omaha.

I appreciate this opportunity to testify because I feel that there are several definite actions which Congress can take to assure that agriculture continues to have a supply of credit on a dependable and competitive basis.

During my testimony today, I will list those actions that we believe are needed...the reasons for the need and the consequences of congressional inaction.

In the letter of invitation to this hearing, Senator Grassley emphasized the need to ensure that credit is available for farmers this spring. I believe the problems that agriculture faces today go beyond the need for credit next spring. They embody the very ability of many farmers to stay in business at all. They affect all institutions which provide services to agriculture. They affect the entire fibre of Mid-America and I believe will soon affect our nation's economy to a greater degree than many people have previously thought possible. Last week's Time magazine pointed out how the midsection of our nation is suffering as a result of our completely unsatisfactory agricultural economy.

Many of our Eighth Farm Credit District directors and officers have stated repeatedly over the past two years that agriculture's problems primarily come down to a lack of profitability. Unprofitability is the end result...it has been brought about by a scenario which unfolded with government budget deficits, a strong dollar against world currencies, dwindling foreign markets, commodity surpluses, low commodity prices, high interest rates, negative cash flows, declining land values, inability to handle debt obligations, a lack of viable loan restructuring alternatives and finally foreclosures...so the scenario has unfolded.

The result has been business failures for many farmers and ranchers and institutions serving them. There will be many more failures if solutions are not found.

Let me say up front that we feel there is no one solution to agriculture's current problems. But there are a number of things which can assist in bringing relief.

The farmer-owned Farm Credit System has been attempting to do what we can to help individual borrowers while simultaneously protecting the interests of borrowers as a group. We have cut costs and are continuing to look for ways to make our operations more streamlined and efficient. We have developed programs to assist those borrowers having financial difficulty...primarily by deeply exploring every workout alternative before foreclosure is pursued. We have developed new interest rate programs based upon the level of risk in individual loans...which has permitted us to get our interest rates down to competitive levels while serving all borrowers equitably. We are revitalizing our efforts to utilize FmHA quarantee loan programs. I have attached a copy of letter which we recently sent to Frank Naylor, chairman of the FCA board, outlining all of the actions which our District has taken to improve our operations and to serve our borrowers better (attachment #1). I have also attached some information summarizing our loan restructuring activities (attachment #2). I would like these inserted as an official part of my testimony.

One of our problems is that in many instances our hands are tied by well-meant legislation which ends up costing our borrowers more and impacting the availability of credit.

One of our primary handicaps is the provision that the Farm Credit Administration must approve all interest rate changes. I know of no other business where the basic right of product pricing is not in the hands of directors and officers. I mentioned that we had developed new individual pricing programs for FLB and PCA interest rates. Yet there are additional loan products and loan pricing techniques which are needed and which would help slow down the devaluation of agricultural land and assist our membership.

Some members of Congress have recognized this legislative problem and currently Senator Cochran has proposed a bill (S-2770) which would put the right of product pricing where it belongs -- within each Farm Credit District. Some members of Congress have proposed increasing the FmHA direct and guarantee loan programs (both ownership and operating). With these types of business initiatives, there would be little need for a secondary market which some have recently promoted. Without Congressional action addressing the right of district boards to price Farm Credit loans, we will be hamstrung in our efforts to develop new products and have competitive loan pricing... and it will be costly to farmers and the System alike.

There are other examples of legislation which adversely affects the way loans are made and serviced. Legislation which artificially changes the loan contract may temporarily help a few stressed farmers, but ends up raising interest rates for other borrowers. For example, in Nebraska LB999 exempts the homestead and 160 acres from foreclosure in some cases. The law was supposed to assist farmers in repurchasing their homestead. Instead it has resulted in the curtailment of credit to the stressed and small farmers. We also see various legislative attempts to change the way lenders can collect on a loan after it has been made. Such laws as delaying collections of deficiency judgements and liberalizing the bankruptcy laws are unfair to borrowers who are working hard to remain current on their loans. It allows a small number of borrowers to avoid their contractual obligations at the expense of the other borrowers who are paying the way. If lenders are handicapped in the way they collect loans, it will change the way they make loans and affect the availability of credit over time.

I realize that this type of legislation comes from a desire of legislators to help farmers who are suffering under the restructuring of agriculture. I also realize that it is easy to point to an institution and say "you're the bad guys."

If this type of legislative action doesn't stop, it will hinder us from working with those borrowers who have a chance to survive.

The Farm Credit System itself is worried about survival. It becomes more and more evident every day that the system will have to request financial assistance from Congress. We have fear that extended congressional debate will take place when that request is made. Research and planning must take place now so that help is in place in time to save the System and its members when it is needed.

The consequence of delay or inaction to assist the Farm Credit System will spell disaster. I cannot believe that any other institution would or could step in on any kind of timely basis and fill the void that would be left if the System fails. We know of the difficulty that many farmers have finding financing when the commercial bank they are with fails. I shudder to think of the havoc created for many borrowers if ever a Farm Credit Bank were to fail.

Let's return to the original question concerning this hearing. The question was, will there be credit available for farmers? The answer is there will be ample credit for farmers if a few things are caused to happen. One of these things is that the Farm Credit System should be allowed to price its own products. Also, government entities should permit lenders to continue to make and collect loans in a businesslike and equitable manner. In addition, Congress should prepare for standby appropriations for the Farm Credit System if and when such assistance is needed.

In conclusion, I believe that we at Farm Credit Banks are striving diligently to address the current agricultural crisis in a constructive and equitable manner. It is my hope that Congress and state legislators will approach the various "solutions" with equal care. Thank you for the opportunity to testify.

# # #

**Farm Credit Banks
of Omaha**

206 South 19 Street
Omaha, Nebraska 68102
402/444-3333

September 10, 1986

The Honorable Charles E. Grassley
United States Senate
SH-135 Hart Senate Office Building
Washington, DC 20510

Dear Senator Grassley:

At your hearing on September 3 in Des Moines, Iowa, you asked that I check on the number of reamortizations that have taken place in the state of Iowa during the first six months. I am told that the number of reamortizations in Iowa for the first six months is 114.

The second request that you had was that we supply you with the policy for the compromise of indebtedness. I am enclosing with this letter our Policy No. 4013 which was approved by the board on January 30, 1986 which is our Policy for Compromise of Indebtedness.

I hope this additional information satisfies the request for information. If I can be of any further assistance, please do not hesitate to contact me.

Sincerely,

James A. Mullins

James A. Mullins, Director
Eighth Farm Credit District

Attachment

EIGHTH FARM CREDIT DISTRICT

POLICY MANUAL

Farm Credit Banks of Omaha

POLICY NUMBER: 4013
FCA REGULATION: 4512

TITLE: Compromise of Indebtedness

OBJECTIVE

To establish a common basis for negotiating compromise of indebtedness that ensures settlements with borrowers who cannot repay the total indebtedness are in the best interest of Farm Credit System stockholders.

PHILOSOPHY

The district policy and procedures implementing the FCBO philosophy on compromise of indebtedness must retain the fundamental requirement that any compromise agreement must provide the greatest net return to the lender. Underlying this policy is the recognition that attention must be given to indirect costs and subjective benefits of each compromise decision.

Indirect costs which affect the net return to the banks and associations as significantly as the direct loss of a compromised loan include:

- employee time used in legal proceedings,
- inadequate servicing of other borrowers while attention is focused on distressed borrowers, and
- loss of income from assets in nonaccrual accounts while working out solutions with borrowers who are unable to pay.

The proper balance of subjective and objective considerations can be achieved only by continued compliance with the basic premise that compromise must provide the greatest net return to the lending bank or association.

The implementation of a more flexibile policy, standards, and procedures makes consistent interpretation, administration, and supervision more challenging. Consistency is enhanced if we remember two significant points about compromise of indebtedness:

- Success in complying with the policy is measured by the probability that a compromise of indebtedness will be beneficial to the lending bank or association and has a reasonable chance of being implemented. Previous successes and failures in loan administration and borrower faults in compliance with the loan contract are significant only as a predictor of the ability to implement the compromise plan. Performance with compromises is evaluated from the financial position, the security position, and the potential for repayment that exist when the probability for a compromise is identified.
- The borrower assumed an obligation to repay the total indebtedness. Certain assets were pledged, through security agreements and mortgages, as tangible evidence of this intention to repay. Any modification of this obligation must provide the best alternative to the lending association or bank to meet its obligation to preserve the equity capital of all member stockholders and repay bondholder investments on schedule.

DEFINITIONS

COMPROMISE OF INDEBTEDNESS: any agreement between the lender and the debtor(s) to settle all outstanding debt to the lender for an amount less than the full contractual obligation and to cancel all previous lending commitments of lender to debtor(s).

PERSON: any individual or legal entity, such as a partnership, corporation, or cooperative.

LENDER: the lending entity contractually involved with the borrower. The Omaha Bank for Cooperatives, the Federal Intermediate Credit Bank of Omaha, the Production Credit Association of the Midlands, and the Federal Land Bank of Omaha are lenders. The Federal Land Bank Associations are lending agents for the Federal Land Bank of Omaha.

FAMILY MEMBERS: parents, spouse, children, siblings, stepparents, stepchildren, stepsisters, stepbrothers, half brothers, half sisters, uncles, aunts, nephews, nieces, grandparents, grandchildren, and any person having such relationship by marriage.

POLICY

District banks and associations may compromise borrower indebtedness when an analysis of the facts and legal considerations establish that the compromise provides the greatest net return to the lending bank or association.

If a proposed compromise of indebtedness involves a borrower common to two or more banks or associations, the lender negotiating the compromise must work with the other system lenders to coordinate actions. Each lender must preserve the interests of its stockholders to the fullest extent feasible.

A director or employee will not participate directly or indirectly in deliberations of a compromise settlement which affects:

- the interest of such director or employee;
- a family member of such director or employee;
- any entity controlled by such director or employee; or
- any entity in which such director, employee, or family member has an interest.

Authorities/ Delegations

The FCBO president and chief executive officer has authority to approve all compromise agreements for the Omaha Bank for Cooperatives, the Federal Intermediate Credit Bank of Omaha, and the Federal Land Bank of Omaha, except as listed below:

- Compromise of indebtedness of the FCBO president and chief executive officer, of any employee of the Farm Credit Administration, or of any member of their families requires prior approval of the FCBO Board of Directors.
- Compromise of indebtedness of a director, officer, or employee of a bank or of any member of their family requires prior approval of the association board of directors and the FCBO Executive Committee.
- Compromise of indebtedness of any director, officer, or employee of an association or of any member of their family requires prior approval of the association board of directors and the appropriate bank committee regardless of the amount of such compromise.

Authorities/ Delegations (Continued)

The FCBO president and chief executive officer may delegate authority to officers, bank committees, and associations as needed to approve compromise agreements on behalf of the banks and associations and to develop standards, procedures, and guidelines to implement this policy.

The FCBO president and chief executive officer is authorized to approve association policies and to delegate approval levels for compromise of indebtedness to the Production Credit Association of the Midlands and Federal Land Bank Associations as contemplated by the Farm Credit Act and Regulations. Any such delegation of authorities will conform to the provisions of the FCBO policy for delegation of lending authorities. Any delegation to an association may be withdrawn by the supervising bank.

Reporting

The bank(s) will provide periodic reports to the FCBO Board of Directors on actions taken under this policy. These reports may be included in routine operating reports or in special reports as necessary to monitor consistent application of the policy and provide information for strategic planning.

Each bank will maintain a record of all compromises, including documentation to support each bank's financial statement.

January 30, 1986

Approved by Board 1-30-86
Approved by FCA N/A

(attachment #1)

**Farm Credit Banks
of Omaha**

206 South 19 Street
Omaha, Nebraska 68102
402/444 3333

August 12, 1986

Mr. Frank W. Naylor, Jr.,
Chairman
The Farm Credit Administration
1501 Farm Credit Drive
McLean, Virginia 22101-5080

Dear Mr. Naylor:

Many individuals both inside and outside the Farm Credit System have numerous concerns relative to the status of the Eighth Farm Credit District. Some of these concerns have been translated into comments expressing either dissatisfaction with the level of information provided on the conditions in the district or questions relative to the adequacy or even existence of controls over operations. Some of the comments have gone beyond the normal concerns that would be expected under the present circumstances and have implied that Omaha is an example of poor management and leadership. Given the specific reference to Omaha, the board and management thought it would be appropriate to provide you with a brief response addressing the key actions taken to date and outlining our plans to cope with the immediate problems and rebuild for the future.

To begin, we would like to describe the environment in which this District has been operating. While agriculture across the nation is under stress, the midwest, specifically the Eighth District, has suffered more than its share. Recent reports on land values show that of all the 50 states, only two, Iowa and Nebraska, have 1986 values that are below or equal to the 1976 values. While agricultural real estate values have fallen by $240 billion across the nation, a majority of that decline (25% or $60 billion) has occurred in the four states which comprise our district. Almost one half of the drop took place in one year, 1985. In addition, the midwest economy, based on grain and livestock, has very little diversification opportunities. The board and management do not expect to use the economic situation as an excuse, but those outside this district must recognize the realities of the environment under which we in Omaha must make decisions.

As early as 1983, the district board recognized that this district might have significant problems if the negative trend in the ag-economy continued. Its initial action was to place the district banks under common management in order to efficiently and consistently solve the problems facing the Omaha District. With the reorganization of the Omaha FICB in April of 1984 and of the Omaha FLB on January 1, 1985, the new management team has accomplished four major objectives:

1. Identified the problems in the portfolio and set up systems to continually monitor developing trends;
2. Corrected lending deficiencies by instituting major changes in lending philosophy, administration, and controls;
3. Implemented effective cost containment measures; and,
4. Anticipated and coped with continued deterioration in the ag economy in our district through a well defined plan.

Although the district makes quarterly reports to FCA and the Capital Corporation, holds informal monthly meetings with FCA's manager in Omaha and invites on site Capital Corporation employees to attend executive committee and board meetings, it seems that many of the system entities are not receiving updated information about our situation. Given comments about the Eighth District, we think it is appropriate to review just a few of the major actions that the District has taken under the new management.

Problem Identification

- Initiated as early as 1984 a district-wide PCA stress study to evaluate current and future position of all 40 PCAs. Updated quarterly until we became participants in Farm Credit System Stress Study to evaluate financial position of System FICBs.
- Encouraged and assisted in completing a comprehensive System task force review of our district PCAs for the Joint Finance Subcommittee followed by a System Task Force review of the Omaha FLB/FLBAs for the JFS. These two task forces employed individuals from across the System.
- Engaged Price Waterhouse to complete an audit of the FCBO resulting in an unqualified opinion. We continue to use Price Waterhouse extensively.
- Implemented Credit Risk Identification and Assessment Program (CRI/AP) to allow complete evaluation and timely evaluation of loan portfolio (all nonperforming loans by 12/31/86; all loans by 12/31/87). This program will provide assessment of the loan portfolio based on individual loan analysis rather than a macro evaluation.
- Implemented GAAP accounting procedures.
- Implemented file certification of documentation in all loans.
- Implemented System Financial and Credit Standards.
- Implemented comprehensive and centralized quality control program reporting to FCBO president.

We believe our approach to problem identification has been and will continue to be a dynamic response to the changing environment; we think your own independent analysis would show that these programs have placed Omaha at or ahead of the position of other districts in the realistic evaluation of the loan portfolio.

Credit Administration and Operational Changes

Part of the responsibility of the management team of the Farm Credit Banks of Omaha is to expect and ensure that our loan officers exercise sound judgment on loan decisions. We expect a complete analysis of all five credit factors and sufficient information to document their decisions. To ensure we have a common philosophy, the board and management made numerous operational changes.

- Introduced and implemented BC/FICB/FLB common management.
- Developed flexible PCA loss sharing agreements for district first self-help prior to PCA merger.
- Developed and introduced PCA differential interest rate program to keep good borrowers.
- Implemented the voluntary liquidation of Valentine and O'Neill PCAs.
- Adopted policy on association restructuring (15 service centers).
- Consolidated budget and financial planning.
- Developed special assistance credit teams to assist associations.
- Implemented FLB interest rate increases in accordance with district first self-help.
- Developed and introduced an FLB differential interest rate for prime borrowers.
- Selected 15 Presidents for jointly managed regions. Developed comprehensive management review process to select possible candidates for future positions.
- Withdrew existing delegations while establishing credit philosophy of new management team. We currently use prior approval and credit committee processes staffed with our most experienced individuals. As regions exhibit their competency in solving credit problems, we will increase delegations.
- Implemented FICB/PCA Financial Assistance Agreement and have met or exceeded all conditions (interest first collection plan, orderly capital stock program for PCA, additional credit review of PCA loan buyout, compliance with all reporting requirements).
- Accomplished PCA merger into a single association.
- Directed the retention of $100 million in loans that could have been purchased by the Capital Corporation. Inadequate lien filings were not a factor in that decision. This district realized over $29 million in savings by not transferring the loans.

- Centralized legal functions and expenses (this district has not lost a legal case due to inadequate legal documentation).
- Implemented differential plan of supervision.
- Implemented FmHA programs (this district is second only to St. Paul).
- Developed and provided extensive credit training programs in bank and regions.
- Centralized acquired property management.
- Implemented single PCA operations with common credit standards and differential interest rates.
- Continued evaluation of association and bank structure to keep work focused on problem areas.

Many of the above actions were not popular, but they were necessary for the survival of the Omaha banks. We fully expect Omaha will once again be a profitable, responsive and dependable supplier of credit to farmers, ranchers, and cooperatives in the Eighth Farm Credit District.

Cost Containment Measures

We continue to adjust our operations to loan volume and cost realities in light of the changing economic environment. We have taken the following actions to limit expenses and move the district to profitability.

- Various branch offices have been closed, excess buildings, furniture and equipment sold or in process of being sold.
- 1986 operating expense budgets were reduced in excess of 10 percent despite significant increases in high risk loans which require high levels of staff time to service.
- Actions have been taken to reduce interest costs to the FLB. This includes an interest swap arrangement that has already saved the bank over $1.5 million since October, 1985.
- The district defined benefit retirement plan was terminated, resulting in $32 million in funds in excess of vested benefits being applied to district needs.
- Long-term government securities have been sold to generate $1.1 million of additional capital in 1986.
- A workload and staffing level analysis has been completed for the regions to assure that only the required number of employees are in the various locations. We reduced employee numbers in the bank and regions from over 2,000 in 1984 to less than 1,500 today (25% decrease). We continue to reallocate resources to high priority credit needs.
- The FCBO building site has been placed on the market.
- New windows have been installed in the FCBO building to save substantial energy costs.
- Benefits have been adjusted - annual leave and life insurance benefits were reduced; medical plan was changed to a coinsurance plan; forfeitures and reserves were used to offset employer contributions.
- Centralized cash management was implemented in the district to reduce funds balances and the number of bank accounts, and to increase efficiencies.
- A direct linkage to the Fedwire system was established to eliminate $100,000 of commercial bank fees.
- An improved telephone system was implemented to reduce telephone costs.
- A variety of additional budget actions were taken including: reduced attendance at conference and training programs; sale of all company-owned automobiles; reduced advertising and public relations programs to lowest possible level; discontinued certain financially related services such as estate planning; eliminated club expenditures; and stringently reduced contributions and memberships.

Future Plans

Board and management not only want to react appropriately to correct credit problems but also feel obligated to establish a plan for recovery. We have only one major objective for 1987-88: return the District to a profitable position. Our resources, human and financial, will concentrate on the following priorities:

1. Reduce the level of non-earning assets and stabilize credit quality through use of loan restructuring programs, FmHA, separate and specialized loan workout units, comprehensive credit training and profitable management of acquired property.
2. Retain good borrowers through competitive, differential pricing programs and encourage new borrowers through new land loans, match-funded, and fixed rate options based on the marginal cost of funds.
3. Reduce operating costs and streamline the organization.
4. Build member, director and employee commitment to FCBO profitability objectives by getting top management out into the regions and in contact with local boards and borrowers.

This district is committed to a realistic and logical planning process that will focus activity on returning the district to a profitable position. We realize that this task will not be easy but we believe we can accomplish the goal. We are keenly aware that we need financial help from the system to accomplish this task and we will judiciously use that assistance.

The foregoing points illustrate just some of the positive actions that we have taken to identify the problem, to control the situation and to improve operations--actions which in our judgment are or were necessary and in the best interest of the district and the system. They represent the facts, and are not based on rumor or conjecture.

Mr. Naylor, it is our intent and desire to work with FCA, the Capital Corporation and FCCA in as positive a manner as possible to return the Farm Credit Banks of Omaha to profitability. We would hope our goals in this regard mirror your own. For this reason, we would appreciate it if you would address all future suggestions or concerns pertaining to the management of the Omaha banks, or management throughout the district, directly to us, including the objective, and factual, basis for your concerns or conclusions. We assure you that any matter you may deem appropriate to address will receive our immediate attention.

Sincerely,

John A. Harling
President and Chief
Executive Officer

Leo A. Allmendinger

Leo A. Allmendinger
Chairman, Eighth District
Board of Directors

cc: Mr. Marvin Duncan, Farm Credit Administration
Mr. H. Brent Beesley, Farm Credit Corporation of America
All Presidents and CEOs, FCS Banks and Entities
All Board Chairmen, FCS Banks and Entities
Mr. Hugh Macklin, FCS Capital Corporation
Mr. Paul Sylla, FCS Capital Corporation
FCS Capital Corporation Board of Directors
The Honorable Ed Jones, United States House of Representatives
The Eighth District Congressional Delegation
Governor Robert Kerry, State of Nebraska
Governor Terry Branstad, State of Iowa
Governor William Janklow, State of South Dakota
Governor Ed Herschler, State of Wyoming
Division Managers, Farm Credit Banks of Omaha

(attachment #2)

Farm Credit Banks of Omaha

Credit Summary Data

6/30/86

I. Number of Borrowers

	6/30/85	6/30/86	% Change
FLB	63,429	53,565	-15.6
PCA	19,437	14,193	-27.0

II. Loans

FLB	No.	Dollars	Percent
Accrual	56,761	$3,953,413,352	82.2
Nonaccrual	5,466	855,640,617	17.8
FLB Total	62,227	$4,809,053,969	100.0
PCA			
Accrual	11,908	$ 600,139,158	84.8
Nonaccrual	2,285	107,363,250	15.2
PCA Total	14,193	$ 707,502,408	100.0

III. Renewals (New Money)

	No.	Volume
Iowa PCAs	2,000	$ 80,708,932
PCAM	5,602	243,534,305

IV. New Loans (FLBAs)

	No.	Volume (New Money)
Iowa FLBAs	80	$ 6,955,700
District Total	239	18,260,300

V. Delinquent Over 90 Days

	No.	Volume
Iowa PCAs	378	$ 29,462,079
PCAM	674	52,263,405
Iowa FLBAs	2,290	363,254,497
District FLB	4,267	716,302,277

VI. Delinquent Over 180 Days

	No.	Volume
Iowa PCAs	76	$ 5,059,515
PCAM	133	9,568,899
Iowa FLBAs	1,190	197,541,838
District FLB	2,502	713,538,916

VII. Forbearances* and Restructurings

	No.	Volume
Iowa FLBAs	188	$ 935,278.50
District FLBAs	352	2,123,132.74

*Includes amount restructured, reamortized, principal amount deferred (3 in Iowa were deferred to 1987) and amount formally extended. Volume represents only the amount actually deferred or reamortized, it does not represent the entire loan balance.

VIII. Compromises Approved 1/1/86 through 6/30/86

	No.	Amount*
Iowa PCAs	127	$ 14,742,497
PCAM	191	19,263,915
Iowa FLBAs	455	44,245,315
District FLBAs	641	60,340,312
District Total	832	79,604,228

*Amount on corporate records following compromise.

IX Collateral Acquired/Transferred to Satisfy Debt

	No.	Volume
PCAM	Not Available	$ 5,514,449
Iowa FLBAs	184	25,565,740
District Total	640	86,315,269

X. Foreclosures

	6/30/86		12/31/85		In Last 6 Months	
	No.	Volume	No.	Volume	No.	Volume
Iowa PCAs	107	$ 20,619,291	97	$ 18,496,747	10	$ 2,122,544
PCAM	183	34,179,054	285	72,356,366	(102)	(38,177,312)
Iowa FLBAs	1,239	199,326,169	1,030	182,752,907	209	16,573,262
Dist. FLBAs	2,179	375,665,167	1,716	318,782,625	463	56,882,542

Senator **Grassley**. I would like to now ask Deane Adams, Ragan Brock, Jim Corum, and John Westfall to come ahead and take your seat at the table. First of all I would like to personally thank Deane and Ragan and Jim for coming because all of them testified last year on a similar hearing I had at the statehouse. And I also want to thank John Westfall who had to come a long way from Ohio to share with us their experiences with the Louisville district.

Deane Adams is a member of the board of directors of the Federal Land Bank of Marshalltown and he's a former chairman of the Iowa Farm Bureau Credit Task Force. Ragan Brock is also a member of that board of directors of the Federal Land Bank in Marshalltown. I would like to add that Ragan has been one of the most active and respected local board members in the district. Both he and Deane have gone above and beyond the call of duty in being spokesmen for Federal land bank stockholders.

Jim Corum is a former legal counsel for the Farm Credit Banks of St. Paul and, of course, in the last couple years I found him very active in representing and advising members of the Farm Credit System of their legal rights and responsiblities. And then John Westfall is a sitting board member for the Federal Land Bank Association of Bellefontaine, OH. That's in the Louisville district. It's my understanding that he has been in that position for 11 years.

I would ask that each of you would summarize as I indicated if your statement is longer than what is suggested. I will start with Deane and then Ragan and Jim Corum and John Westfall. That's the way I introduced you.

STATEMENT OF A PANEL CONSISTING OF DEANE ADAMS AND RAGAN BROCK, MEMBERS, BOARD OF DIRECTORS, FEDERAL LAND BANK, MARSHALLTOWN; JAMES M. CORUM, FORMER LEGAL COUNSEL, FARM CREDIT BANKS, ST. PAUL; AND JOHN WESTFALL, BOARD MEMBER, FEDERAL LAND BANK ASSOCIATION, BELLEFONTAINE, OH

Mr. **Adams**. I will summarize, Senator Grassley, and I do appreciate the chance of being able to testify because I believe that we need a strong Farm Credit System and the need has never been more than it is today. But along those lines we need leadership that wants the same thing bad enough and I think that's the key. As I listen to the testimony up here the finished picture is in the eye of the beholder and the artists probably in this case have different ideas and a different beholding of what that final picture is.

My picture is a strong Farm Credit System mainly because there's no competition out there for long-term land rates that we need in the Farm Credit System. I have drawn up a couple charts. One of the reasons is I hear that Farm Credit has made loans to farmers they shouldn't have made and I want to emphasize those guys and those loans are already gone and we are trying to pickup those losses. Those people have left one way or the other.

The chart that I have is a debt-to-asset ratio loan made in 1980 of 33 percent and that even decreases in 1982 down to 23 percent debt-to-asset ratio. Anybody would have made that loan. Anybody in the banking business would have made that loan. But today that loan is a 66-percent debt-to-asset ratio. That person is spending almost 86 cents on a bushel of corn on an average yield of 120 bushels to the acre for his interest rates alone.

Now, the corn market in our area is $1.21 which emphasizes two things, that we need a strong farm program to get out of this mess too. But I want to illustrate in that chart that anybody would have made that loan at that time. My second chart illustrates what has happened in our association. In 1 year—I'll just go back to last year. The last year we have dropped 34 percent of our volume and we've only made four loans the last 6 months.

I don't think that you have to look at that chart very long until you know that the crisis in agriculture is—I'm going to compare it to the space shuttle crisis, but I think it makes the space shuttle crisis look like a Sunday school picnic. I believe that probably being a farmer that I am prejudiced about that—it depends where you are, but I think it has the same impact and I think we have heard some of the same things.

The engineers were saying that that space capsule should not have gone up. The administration said, "It has to go up." I have heard some of the same comments on Farm Credit. The directors and the people in the firing line have said that we need things like lower interest rates, we may even need Federal help quicker, we need one interest rate. Merger is not as important as these things.

We have heard all kinds of things like that, yet our response has been we will solve our problems with higher interest rates, we will have five tiered interest rates even when 75 percent of the people in the Omaha district said, "We want one interest rate." We have to merge.

I'll have to admit, we have not had that in the last couple of meetings, but ahead of that merger was very important. We still hear today—we hear the Farm Credit Administrator say, "We don't need any help." I would like to illustrate that. Every farmer would understand that if you walk out into a lot and you see a sick steer out there, we would know that immediately. And we have known that for 2 or 3 years, this place is getting sick, but you don't really do anything until they fall down on the ground. I think that's my interpretation that they want to treat this system after it has fallen completely apart.

We today have interest rates, the cost is 10.8 and we're paying 13¼ Land Bank interest rates. Just the other day, August 26, the Fed lowered the interest rate a half a percent and the stock market jumped 34 points. The same thing could happen here. When Chrysler was rebuilding the car, they asked people what kind of a car and they told the engineers to build it.

I think we have the dedicated people in the Farm Credit System to build the kind of a Farm Credit System that we want if we build it like what the people want, not what the engineers want. I believe now that the district people—like I said, we have even the last couple years, the last time we had directors, the district board came in and the local district directors and we met separately. We met separately. Now, we had never done that before. We had done it one other time maybe. We got a lot of things aired out.

In my closing statement, what can we do to help farmers? I think one thing we need to do is to move the deficiency payment from October, the last deficiency payment, up to April like it has been. I will close with that.

[Prepared statement follows:]

PREPARED STATEMENT OF DEANE ADAMS

MY NAME IS DEANE ADAMS AND I AM PROUD TO HAVE BEEN A FEDERAL LAND BANK DIRECTOR SINCE 1980. I AM HERE TODAY TO TELL YOU THE TIME HAS NEVER BEEN GREATER FOR A STRONG FARM CREDIT SYSTEM. WE NEED A FARM CREDT SYSTEM THAT IS STRONG ENOUGH TO STABILZE LAND PRICES AND DECREASE INTEREST RATES AND WE NEED LEADERSHIP THAT WANTS THAT SAME THING BAD ENOUGH TO MAKE IT HAPPEN.

MY FIRST CHART ILLUSTRATES A CONSERVATIVE FARMER IN OUR AREA THAT IS DOING A GOOD JOB AND HAS AN AVERAGE YIELD OF 120 BUSHELS PER ACRE CORN. INTEREST CHARGES PER ACRE HAVE GONE FROM $78 AN ACRE IN 1980 TO $106 IN 1986 OR A 36% INCREASE. INTEREST WAS COSTING HIM .65 A BUSHEL IN 1980 AND RAISED TO .88 IN 1986. CORN PRICE TODAY 1.21. HIS DEBT TO ASSET RATIO WENT FROM 33% TO 66% AND HIS DEBT NEVER CHANGED PER ACRE. HE DOES NOT QUALIFY FOR THE NEW REDUCED DIFFERENTIAL INTEREST RATE. ANYONE WOULD NOT MAKE THIS LOAN IN 1980. FARM CREDIT CANNOT BE FAULTED FOR THAT.

DATE	INTEREST RATE (A.P.R.)	DEBT PER ACRE	INTEREST PER ACRE	INTEREST PER BUSHEL CHARGE	LAND VALUE	DEBT ASSET
1-1-80	9.75	800	78.00	.65	2400	33.0%
1-1-81	11.00	800	88.00	.73	2800	28.6%
1-1-82	13.00	800	104.00	.86	3500	23.0%
1-1-83	12.25	800	97.60	.81	2800	28.6%
1-1-84	12.75	800	104.00	.86	2000	40.0%
1-1-85	14.25	800	114.00	.95	1500	53.[illegible]
1-1-86	13.25	800	106.00	.88	1200	66.[illegible]

MY NEXT CHART ILLUSTRATES THE LOANS OUTSTANDING AND NEW BUSINESS OF THE MARSHALLTOWN FEDERAL LAND BANK ASSOCIATION DUE TO RECENT INTEREST RATE INCREASES.

	# LOANS OUTSTANDING	VOLUME LOANS OUTSTANDING	LOANS CLOSED (JAN-JUN)	LOANS PENDING TO CLOSE
7-01-83	3319	293.6 MIL.	134	52
6-30-84	3267	290.9 MIL.	97	48
4-30-85	3175	279.7 MIL.	---	27
5-31-85	3156	276.2 MIL.	---	15
6-30-85	2981	261.6 MIL.	46	10
7-31-85	2858	248.3 MIL.	---	5
6-30-86	2175	167.3 MIL.	4	0

THE CHART INDICATES A 87% DROP IN LOANS MADE AND A 34% DROP IN VOLUME OUTSTANDING SINCE 6-30-85.

I BELIEVE AFTER READING THIS CHART IT IS FAIR TO SAY WE ARE IN A CRISIS SITUATION. I COMPARE THE CRISIS WITH THE SPACE SHUTTLE CRISIS BUT I THINK THE AG CRISIS MAKES THE SPACE CRISIS LOOK LIKE A SUNDAY SCHOOL PICNIC. WHEN I SEE HOW IT IS TEARING THE HEART OF THE MID-WEST. WHEN I WAS LISTENING TO TESTIMONY ON THE FAILURE OF SPACE CAPSULE I DETECTED SIMILAR STATEMENTS THAT I HAVE HEARD DURING FARM CREDIT MEETINGS. THE ENGINEERS SAID THE CAPSULE SHOULD NOT GO UP IT WOULD NOT WORK AND THE ADMINISTRATION SAID IT WOULD AND THAT IT HAD TO GO.

I HAVE HEARD THE SAME THING IN FARM CREDIT. THE DIRECTORS AND PEOPLE ON THE FIRING LINE SAY WE NEED THINGS LIKE LOWER INTEREST RATES, NEEDED FEDERAL HELP, NEEDED ONE INTEREST RATE, MERGER WAS NOT AS IMPORTANT AS GETTING THIS THING DONE. ADMINISTRATION FROM DISTRICT BANKS AND WASHINGTON D.C. SAID INTEREST RATES ARE NOT THAT IMPORTANT, WE DO NOT NEED HELP, WE HAVE TO HAVE 5 INTEREST RATES, EVEN WHEN 75% OF PEOPLE POLLED IN THE OMAHA DISTRICT WANTED ONE INTEREST RATE. WE HAVE TO MERGE. WE STILL HEAR THE HEAD OF F.C.A. SAY WE DO NOT NEED HELP, WE CAN NOT ALL OF US HAVE LOWER INTEREST RATES JUST A FEW, MAYBE 40% OF OUR VOLUME.

WHEN THE ECONOMY NEEDED A BOOST AUGUST 26 THE FED. LOWERED INTEREST RATES AGAIN ½% AND STOCK MARKET JUMPED 34 POINTS. OUR AVERAGE COST TODAY IS 10.8% WE ARE STILL PAYING 13¼ LAND BANK RATES.

WHEN CHRYSLER WAS REBUILING THEY ASKED THE PEOPLE WHAT KIND OF CAR THEY WANTED AND THEN TOLD THE ENGINEERS TO BUILD IT. IN FARM CREDIT WE HAVE MANY DEDICATED PEOPLE. WE HAVE THE EXPERTISE AND COMMITMENT TO REBUILD AGRICULTURE IF THEY WERE GIVEN THE CHANCE TO BUILD WHAT THE PEOPLE WANTED INSTEAD OF ENGINEERS.

I BELIEVE NOW THE DISTRICT PEOPLE DO WANT HELP. I BELIEVE THE PEOPLE AT F.C.A. HAVE INTERPRETED THE NEW FARM CREDIT LAW IN SUCH A WAY WE ARE GOING TO LOSE A LOT OF DIRECTORS BECAUSE OF DISCLOSURE STATEMENTS AND ALL THE POWER TO SET INTEREST RATES ARE GOING TO F.C.A. I DO NOT BELIEVE WE CAN STRENGTHEN OUR CREDIT SYSTEM THIS WAY. I BELIEVE WE SHOULD SUPPORT S 2720 WHICH PUTS IT BACK TO DISTRICTS. ONE THING WE COULD DO FOR FARMERS IS GET THE LAST HALF OF DEFICIENCY PAYMENTS MOVED UP TO APRIL 1987 INSTEAD OF OCTOBER.

Senator **Grassley**. OK.

Mr. **Brock**. A year ago—I'm going to depart from my text here because first of all I'm not very proud of it. Due to the mixup in the mail I dictated this to your secretary. I'm not blaming her, but between my dictation and her typing there's some errors in here.

Senator **Grassley**. You want us to not include your statement in the record then?

Mr. **Brock**. I would just as soon not and I would just as soon state my feelings. A year ago I appeared before your committee and I was very critical of the people in Omaha. I think that that situation has changed and I think you have had the opportunity to witness here this morning two people, Tom Stinson and Jim here, that I think they are certainly—I'm proud of what they have said here this morning. They are representing agriculture well.

I think that one of the things that has happened is that in the Farm Credit Administration there's a great deal of confusion about what is taking place in Washington and what is taking place out here on the farm. I share your concern that things are not going to get better in the near future. I would like to read just some of my concern.

Recently officials high up in the Farm Credit Administration; namely, Frank Naylor, Chairman of the Board, indicated at a meeting addressing a Farm Bureau group in Des Moines that borrowers had a right to their entire loan file record. I had several other witnesses with me that can testify that this is what Frank Naylor indicated. The point is he was not correct.

Section 4.13A of the Farm Credit Act titled "Access to Documents and Information" says,

> In accordance with regulation of the Farm Credit Administration, system institutions shall provide their borrowers at the time of the execution of loans copies of all documents signed by the borrower and at any time thereafter at the borrowers request copies of all documents signed or delivered by the borrower and at any time on request copies of the institution's articles of incorporation or charters and bylaws.

My interpretation indicates that this does not mean the entire loan file record.

Another concern is that Frank Naylor, Chairman of the Farm Credit Administration, has indicated on several occasions that he has encouraged district banks to reduce their interest rates. On the contrary. I have documented evidence that the district bank in Omaha requested to drop ratings much more than what the FCA approved which was only one-half of 1 percent on a blended average to all customers over three banks in the district.

Another issue in dispute is, Mr. Naylor indicated at that meeting in Des Moines that the farmer member and stockholders own and control this system. Well, as a director of a Federal Land Bank Association I can testify that many items such as budget approval and so on are now dictated by the capital corporation and FCA rather than what the owners and members wish. Thank you.

Senator GRASSLEY. Before we go on, I wonder, Mr. Duncan, I would like to ask you, what is the policy based upon access to files?

Mr. DUNCAN. The policy as I understand it with regard to access to files is as the gentleman has indicated, that a borrower has a right to everything that he has signed in that file or has, as I understand it, delivered to the lender.

Senator GRASSLEY. OK. So Frank's statement was incorrect at least as interpreted by Ragan Brock?

Mr. DUNCAN. I was not there to hear the statement. I am unable to verify that.

Senator GRASSLEY. I shouldn't have expected you to. Do you plan on any change in that policy to allow a member to have access to everything in his file?

Mr. DUNCAN. At this point, no.

Senator GRASSLEY. What is the reasoning that you wouldn't be thinking in terms of having a member have access to everything in his file?

Mr. DUNCAN. There are likely to be in files, documents that are related to property valuation, things of that sort that are part of the business of the lending institution and ought to be. The lending institution ought to be able to have some of its working documents held confidential to that institution. Now, everything that the borrower signs that borrower ought to be able to have access to.

Senator GRASSLEY. I guess maybe I would come from the standpoint of the borrower's basic right to know, but I guess this isn't the forum for arguing that. Mr. Corum. Thank you, Mr. Brock.

Mr. CORUM. Thank you, Senator. It's a distinct pleasure to be a witness at this hearing. When a farmer borrower comes to me for legal help, a farmer borrower of the Farm Credit System, the first thing I ask him is whether or not he has explored restructuring of his loan under the system's foreclosure law or most recently under the Senate and House concurrent resolutions introduced March 27, 1986, and May 13, 1986, respectively.

The typical response, and this is unchanged in the past 2 years, is that the system is more concerned in protecting itself rather than going the extra mile in an endeavor to help the family farmer stay in business.

As to the specific suggestions for restructuring the troubled loans contained in the concurrent resolutions, namely don't foreclose if the cost exceeds restructuring and restructure by a write-down of principal and interest when the farmer has a reasonable chance to survive, the usual association position is similar to that contained in the farmer's letter which I have attached as exhibit A, Senator, to my statement to the effect that the loan officer has never heard of the congressional resolutions and, in any event, pursuant to their legal advice such requests are not law and therefore not binding on the association and therefore they will not consider it.

The system's reaction to congressional and public outcry against the dizzying pace of farm foreclosure appears to be a stepped-up policy giving lip service to some reduction in foreclosure intensity as evidenced by the Farm Credit Council's May 8, 1986 letter to Congress announcing new guidelines for restructuring troubled loans and at least in one district the rumored hiring of a prestigious public relations firm to conduct lobbying efforts and to attempt to change a badly tarnished image.

Meanwhile association loan officers continue to disavow any knowledge of new restructuring policies and continue in their refusal to restructure troubled loans in a meaningful and effective way to the farmer. In fact, two FLBA loan officers in Iowa advised me that they have no duties of forbearance since, quote, the Farm Credit System has no government money in it, end of quote.

The duty of the system to make loans that, quote, improve the income and well-being of the American farmer, end of quote, which is in their charter, and also to exercise disciplines to assure that the farmer's recovery is made are apparently only discussed in some executive circles and have not filtered down to the field to the loan officers.

The following remedial action is past due: No. 1, continue to apply congressional pressure upon FCA to ensure that association loan officers do become aware of the fact that they are not like local bankers. They are officers of the Farm Credit System that has entirely different duties under the law and that their prime concern must be to restructure troubled loans to save family farmers that, again a quote, show a high probability of return to financial stability, end of quote, which is taken from the system's own guidelines promulgated on May 6, 1986.

Second, apply new congressional pressure upon FCA to ensure that borrowers may finally obtain a stockholder list so that they can have a proper corporate purpose including a meeting with their brother stockholders to discuss issues concerning them as stockholders of a system that they allegedly own and I have heard today control. They can't even get the membership list yet.

Now, I'm glad Mr. Duncan is here because FCA in the Federal Register May 16, 1985 took the position, quote, that an association, stockholder has a right to obtain the stockholder list for a proper corporate purpose, end of quote. And certainly, Senator, if getting together with your brothers and sisters in this cooperative is not a proper corporate purpose, I can't imagine what would be.

Thus, a two-pronged approach. One, by congressional pressure on FCA and second by stockholder direction to their local association, system executives may well become convinced to exercise more effort to restructure troubled loans. The system must never be allowed to forget the reason that Congress created it.

As former FCA Governor Wilkinson admitted during questioning by Congressman Whitten of Mississippi at the 1983 hearings of the committee on appropriations, again a quote, Mr. Wilkinson. The Farm Credit System, as we know it today, totally came together in 1933. Congressman Whitten. The purpose of it was to save people from losing their farms and to keep people from going broke. That was the purpose of it? Mr. Wilkinson answered, Yes, sir. Thank you.

[Prepared statement and material follows:]

PREPARED STATEMENT OF JAMES M. CORUM

My name is James M. Corum. From 1968 until 1983, I held the position of General Counsel for the FICB/BC and until September 4, 1984, I was director of the Credit/Legal Operations of the PCAS and FLBAS in the St. Paul district. My employment was involuntarily terminated at a later date. I was advised that my termination resulted from failure to support the 7th District's association reorganization and common territories program. Since that time I have conducted legal seminars in 10 states advising farmers of their rights under Farm Credit Law and have defended farm credit borrowers in foreclosure actions brought by the PCAS and FLBS.

When a farmer-borrower of the Farm Credit System seeks my legal help, the first think I ask is whether or not he has fully explored restructuring of his loan under the System's foreclosure law or, most recently, under the Senate and House Concurrent Resolutions introduced March 27, 1986 and May 13, 1986 respectively. The typical response -- unchanged in the past two years -- is that the System is more concerned in protecting itself rather than going the extra mile in an endeavor to keep the family farmer stay in business. As to the specific suggestions for restructuring troubled loans contained in the Concurrent Resolutions -- don't foreclose if the cost exceeds restructuring and restructure by a write-down of principal and interest when the farmer has a reasonable chance of survival -- the usual association position is similar to that contained in the farmer's letter attached as Exhibit A, to the effect that the loan officer has never heard of the Congressional Resolutions and, in any event, such requests are not law and therefore not binding on the Association.

The System's reaction to congressional and public outcry against the dizzying pace of farm foreclosures appears to be a stepped up policy giving lipservice, to some reduction in foreclosure intensity as evidenced by the Farm Credit Council's

May 8, 1986 letters to Congress announcing new guidelines for restructuring troubled loans and at least in one district, the rumored hiring of a prestigious public relations firm to conduct lobbying efforts and to attempt to change a badly tarnished image. Meanwhile, association loan officers continue to disavow any knowledge of new restructuring policies and continue in their refusal to restructure troubled loans in a meaningful and effective way. In fact, two FLBA loan officers in Iowa advised me that they have no duties of forbearance since "the Farm Credit System has no government money in it!" The duty of the System to make loans that "improve the income and well-being of American farmers" and to exercise disciplines to assure the farmer's recovery apparently are only discussed in executive circles and have not year filtered down to the association loan officers that deal with troubled farmers on a daily basis.

The following remedial action is past due:

1. Continue to apply congressional pressure upon FCA to ensure that association loan officers become aware of the fact that their association is not the same as any other farm banker and that their prime concern must be to restructure troubled loans to save those family farmers that "show a high probability of return to financial stability" as stated in their our guidelines of May 6, 1986.

2. Apply new congressional pressure upon FCA to ensure that borrowers may finally obtain a stockholder list of other borrowers for a proper corporate purpose including the right to call special stockholder meetings to discuss remedial stockholder actions for violations of stockholder--borrower rights. The FCA position "that an association stockholder has a right to obtain the stocker list for a proper corporate purpose" (Fed. Register, p. 20398, Vol. 50, No. 95, Thursday, May 16, 1985), has apparently not been communicated to System institutions in a meaningful way.

Thus, a two-pronged approach -- one by Congressional pressure on FCA and secondly, by stockholder direction to their local association, System executives may well become convinced to exercise more effort to restructure troubled loans.

The System must not be allowed to forget the reason that Congress created it. As former FCA Governor Wilbinson admitted during questioning by Congressman Whitten of Mississippi, at the 1983 Hearings of the Committee on appropriations:

> "Mr. Wilkinsin. The Farm Credit System, as we know it today, totally came together in 1933."
> Mr. Whitten. The purpose of it was to save people from losing their farms and to keep people from going broke. That ws the purpose of it?
>
> Mr. Wilkinson. Yes, sir."

EXHIBIT A

August 26, 1986

Mr. James M. Corum
5517 Morgan Ave. No.
Minneapolis, MN. 55430

Dear Mr. Corum,

First I would like to thank you for representing me in the State mediation meeting with the Federal Land Bank of Southeast Minnesota. As you can recall from our July meeting with them, we tried to negotiate a cash settlement for the debt I owed them. They were comparing my farm with a farm three miles from me and told me they received $750.00 per acre when in fact after I produced a copy of the mortgage contract they had only received about $420.00 per acre, and the contract was 10 % interest and didn't require the new buyers to purchase stock in the Farm Credit System. Then when I asked them about other contracts they had at 9 % interest and 8 % interest, which is 3 to 4 points less than their blended cost of money to our SE association, who makes up the difference? They replied that they didn't want to talk about it.

It was also very evident that they used personal property building sites and non-tillable land, to raise the average selling price per tillable acre. And yet they put very little or no value at all on the personal property when the farm was sold. Property such as new bulk tanks, pipe line milkers, bunk feeders, silo unloaders, manure pumps. These practices have upset all the stockholders, current and noncurrent ones.

At the close of our meeting you read the resolution passed by the United States Congress and asked that if they couldn't take my cash offer that they offer to restructure with the two tier debt plan suggested by Congress. In the follow-up meeting later in July they refused to offer me the two tier debt plan suggested by Congress. I asked why and their reply was, " that they had checked with their attorney and that the resolution we read from Congress had no legal or binding hold, it was merely a suggestion to do it ". They also stated that they had no intention of ever offering that solution to me in my case.

The offer Federal Land Bank has made us would make it financially impossible to continue farming our family farm. My wife and I and our four small children love to farm and would like to continue to farm if at all possible. Please advise if you have any ideas or suggestions that would help our problem.

Sincerely yours,

Russell Foss
RR3 Box 157
Kenyon, Minnesota 55946

Senator GRASSLEY. Before we go to Mr. Westfall, once again let me turn to Mr. Duncan because Mr. Corum brought up something that I brought out at my hearing 1 year ago and I have had a long interest in and that is the ability of a member to know who the other members are so they can talk. I'm not sure that I was aware of this regulation. But how does the Farm Credit System view that regulation today and do they see as a corporate purpose just members themselves getting together to talk to each other about the future of their system?

Mr. DUNCAN. I'm unable to answer that, Senator. I simply don't know how the institutions do that. I do know when we send examiners out to these institutions we're going to be examining to make sure that they have either complied with all rules and regulations or if they have not, we will exercise appropriate supervisory measures to assure that.

Senator GRASSLEY. Well, as a policymaker, can I ask you how you personally feel about the use of the list by other members for the purpose of communicating about the system itself?

Mr. DUNCAN. For communicating on legitimate business purposes the regulations are clear.

Senator GRASSLEY. So getting preparation ready for stockholder meetings would be a legitimate corporate purpose as you would see the regulation being interpreted?

Mr. DUNCAN. Communicating with other stockholders for legitimate association or bank business, in my interpretation of the regulations, indicates that that is an appropriate use of stockholder lists.

Senator GRASSLEY. Before I go to Mr. Westfall then, a personal comment from me in regard to another thing that Mr. Corum reminded me of, how certain employees react to what should be a policy or to implement a kind of contrary policy. I was recently reminded of this at a meeting that I had in western Iowa just Saturday.

One former board member told me that he recently had an employee tell him that it's much easier to foreclose than it is to work out an agreement for the future. It kind of reminds me of what I tell my own employees on my own staff, that kind of follows the advice of Mrs. Helmsley, the hotel owner. I read her advertisement. She says, "I don't have to tell my people to be nice because I hire nice people."

And I tell my staff that. I don't want any constituent getting mad at me for anything that my staff has done. If they want to get mad at me for something I have done in standing up to a constituent or something like that, OK, but I don't want my staff to.

I would think it would be the same thing for the Farm Credit System, that each of those institutions would want to see that each of their employees very duly carry out the policies of those institutions, such that every employee of the system is an extension of the purpose of the system and the attitude of the top officials, assuming that the attitude at the top is correct.

Maybe that's evidence that maybe the attitude at the top isn't as it ought to be or maybe the people down below wouldn't be expressing the wrong attitude. But in my case of Senator Grassley, I want my attitude to be expressed by my staff and that better be one of listening as best we can. You know, with 2$\frac{9}{10}$ million constituents we are to at least listen to our people's point of view. Mr. Westfall.

Mr. **Westfall**. I apologize. Everything I'm going to say has already been said and I would rather be home feeding cattle anyhow. We have known since 1979 that the direction and the philosophies of the Federal Land Bank have been wrong. The philosophy of the bank was to continue to get bigger, more volume with higher salaries, more cost. It was easy to sit back and watch this evolve with increased inflation and comparatively good prices for commodities. Now the bubble has burst and we have to try to pick up the pieces.

As you already know, the trend of the banks was to continue to get bigger. In so doing it continually took stronger control of the System and eliminated the input of directors and shareholders. Thus, the demise of the grassroots system that any good co-op is built upon.

Our local FLBA had agreed at one time to merge with the PCA and have joint management. In our district 26 new associations were formed. But before the program had been fully implemented another plan evolved. The pressure the bank put upon us was unbelievable. They threatened to have us sued and take our farms away.

I have heard of some directors having loans reclassified. Our association eventually turned us down along with 15 other associations. Now we have 10 FLBA's and 5 PCA's and 1 big consolidated association. The chairman of the district board wrote letters to our shareholders urging them to vote for consolidation to one association. Our board then sent our own letter to our shareholders—we were advised not to do this—and told them the pros and cons as accurately as we could. Our proxy votes voted down 3 to 1 and there were only 3 affirmative votes at our shareholders meeting.

To put this all together, disclosure packets, voting and meetings probably cost our district over $1 million. Now the bank has asked and received permission from FCA to interpret the rules so the shareholders of the one association would not have to vote or put out a disclosure packet to accept our association into the new merger, another way to make it easier for us to join this association.

This has shown that FCA can bend the rules as they see fit. A different interpretation. In the meantime our bank has raised interest rates again. Our advisory board recommended our district president be replaced and only through infusion of new board members was this accomplished. Seven out of nine of the board members now are new.

We have been asking for new leadership for several years now. Well, we finally have new leadership, but in so doing we have a great structural change also. It seems every time we get a change they attack our structure and it seems they will do even more in the future. The change of personnel policies in the FCA was necessary and justified. Now we have a new structure of Farm Credit Administration and we have a tiger by the tail.

The new chairman of the FCA seems to be more of a politician than an administrator of Farm Credit. The slowness of FCA to get organized is terrible. As far as I know the third man of FCA has not yet been appointed. Now, we have been asking for lower interest rates for months and the FCA will not permit this decrease. They will allow a half percent when we need at least 3. Presently we are not competitive and are losing our good borrowers in droves.

We cannot exist on marginal loans and nonaccrual which will always be left. It seems that FCA will slowly let the Farm Credit System bleed to death and then come in with another great structural change. I can only surmise what this would be. An educated guess would be the elimination of all district banks and the formation of three or four associations across the Nation. This is where the new Farm Credit Corporation comes in. They probably will have the power to do anything they want with restructuring farm debts. Farm Credit Corporation is another level of bureaucracy we do not need.

In the past several years we have had several changes or attempted changes in our structure. Each time it was an attempt to get bigger. The bigger we got the more cumbersome we became. We had more red tapes, more rules, more paperwork, higher and higher salaries and costs. We farmers are a unique clan in that we trust one another and like to talk business with a person face to face. Our CEO has had so much paperwork to do, forms to fill out, et cetera, that they lost contact with the business of loaning money to a prospective shareholder.

If we had continued the last 10 years to have small associations with more director input, we would have eliminated a lot of problems. Presently there is a bill in the making in Congress that would permit the district banks to set their own interest rates. Why should Congress have to do this? If Congress passes a bill to lower interest rates and it is asked to supply money for survival of Farm Credit, this just won't add up to some Congressmen. FCA should have taken the step to lower interest rates long ago.

Farm Credit still has about 30 percent of agricultural loans. We very definitely need a farm credit service for the survival of the farm economy. To do this we most assuredly would need an infusion of Government money. If and how we get this money is all important. A loan would be one thing, but just an outright infusion of money with many strings attached is quite another story. I can imagine the situation with many strings attached, Farm Credit would be just another Government agency. We already have the FmHA which has always been a disaster in our area.

It seems that the administration's policies are to undersell the world in the farm commodity market, to drop completely the farm program and if you buy a bushel of grain somewhere else, then buy it there. This really doesn't sound too bad. We as farmers would like to sell to the world and do a good job of feeding most of them. We never did like the farm programs and I am a firm believer in the free enterprise, but that's where it stops.

As long as our Government continues to loan foreign governments money and they in turn undersell us on world trade, as long as our Government continues to use our agricultural products as pawns in the world of politics and as long as our administration continues to think we have too many farmers, we will continue to have monumental problems. The two main problems we have in agriculture are high interest rates and low commodity prices. Give us low interest rates and good crop prices and we will turn this thing around in a short time. Presently there's a bill S. 2770 in the making that will give us immediate relief in our interest rates. We needed this lower interest rate months ago.

We appreciate all the help we can get with the passing of this bill. Thank you for the opportunity to speak.

[Prepared statement follows:]

PREPARED STATEMENT OF JOHN WESTFALL

The written testimony for the Senate Judiciary Subcommittee on Administrative Practice and Procedure.

I am John Westfall, farmer for 35 years in West Central Ohio, shareholder of Federal Land Bank for 20 years and a director of Federal Land Bank Association of Bellefontaine for 11 years.

We have known since 1979 that the direction and philosophies of Federal Land Bank have been wrong. The philosophy of the Bank was to continually get bigger, more volume and with that higher salaries. It was easy to sit back and watch this evolve with increased inflation and comparatively good prices for our commodities. Now the bubble has burst and we have to try to pick up the pieces.

As you already know, the trend of the Banks was to continually get bigger. In so doing, they continually took stronger control of the system and eliminated the input of directors and shareholders, thus, the demise of the grass roots system that any good co-op is built upon.

Our local F.L.B.A. had agreed at one time to merge with the P.C.A. and have joint management. In our district 26 new associations were formed. But, before we had this program fully implemented, another plan evolved. The pressure the Bank put upon us was unbelievable. They threatened to have us sued and have our farms taken away. I have heard of some directors having their loans reclassified. Our association eventually turned this down along with 15 other associations. Now we have 10 F.L.B.A.'s, 5 P.C.A.'s and one big consolidated association. The chairman of the District Board wrote letters to our shareholders urging them to vote for consolidation into one association. Our Board then sent our own letter to our shareholders (we were advised not to do this) and told them the pros and cons as accurately as we could. Our proxy votes voted it down 3 to 1 and there were only 3 affirmative votes at our shareholders meeting. To put this all together—disclosure packets, voting and meetings probably cost our district over one million dollars. Now the Bank has asked and received permission from F.C.A. to interpret the rules so the shareholders of the one association would not have to vote or put out a disclosure packet to accept our association into the new merger. Another way to make it easier for us to join.

This has shown that F.C.A. can bend the rules any way they want.

In the meantime our Bank had raised interest rates again. Our advisory board recommended that our District President be replaced and only through the infusion of new board members was this accomplished, seven out of nine new members.

We have been asking for new leadership for several years now. Well, we finally have new leadership, but in so doing we have a great structural change also. It seems that every time we get a change they attack our structure and it seems they will do even more in the future. The change of personnel and policies in the F.C.A. was necessary and justified. Now we have a new structure of Farm Credit Administration and we have a tiger by the tail.

The new chairman of F.C.A. seems to be more of a politician than an administrator of farm credit. The slowness of F.C.A. to get organized is terrible. As far as I know the third man of F.C.A. has not yet been appointed. Now we have been asking for lower interest rates for months and F.C.A. will not permit this decrease. They will allow ½ percent when we need at least 3 percent. Presently we are not competitive and are losing our good borrowers in droves. We cannot exist on marginal loans and non accrual loans which will be all that's left. It seems that F.C.A. will slowly let the farm credit system bleed to death and then come in with another great structural change. I can only surmise what this would be. An educated guess would be the elimination of all district banks and the formation of three or four associations across the nation. This is where the New Farm Credit Corporation comes in. They probably will have the power to do anything they want with restructing of farm credit. Farm Credit Corporation is another level of bureaucracy we do not need!

In the past several years we have had several changes or attempted changes in our structure. Each time it was an attempt to get bigger. The bigger we got, the more cumbersome we became. We had more red tape, more rules, more paper work and higher and higher salaries. We farmers are a unique clan in that we trust one another and like to talk business with a person face to face. Our CEO's had so much paper work to do, forms to fill out, etc. that they lost contact with the business of loaning money to a prospective shareholder.

In our District's last attempt to consolidate, our Association defeated this merger. The Bank was ruthless in their attempt to force us into consolidation, even to the extreme of threats of losing our farms! The pressure on our Association still continues to consolidate.

If we had continued in these last 10 years to have smaller associations with more director input, we would have eliminated a lot of problems.

Presently there is a bill in the making in Congress that would permit the District Banks to set their own interest rates. Why should Congress have to do this? If Congress passes a bill to lower interest rates, then is asked to supply money for the survival of Farm Credit—this won't add up to some congressmen. F.C.A. should have taken the step to lower interest rates long ago.

Farm Credit still has about 30% of the agricultural loans. We very definitely need the Farm Credit Services for the survival of the farm economy. To do this we most assuredly will need an infusion of government money. If and how we get this money is all important. A loan would be one thing, but just an outright infusion of money with many strings attached is quite another story. I can imagine the situation, with many strings attached, Farm Credit would be just another government agency. We already have the FmHA which has always been a disaster in our area.

It seems that the administration's policies are to undersell the world in the farm commodity market, to drop completely the farm program and if you can buy a bushel of grain somewhere else, buy it there. This really doesn't sound too bad. We as farmers would like to sell to the world, and do a good job of feeding most of them. We never did like the farm programs and I am a firm believer in free enterprise, but that is where it stops. As long as our government continues to loan foreign governments money and they in turn undersell us on world trade, as long as our government continues to use our agricultural products as pawns in world politics, and as long as our administration continues to think we have too many farmers, we will continue to have monumental problems. The two main problems we in agriculture have are high interest rates and low commodity prices. Give us low interest rates and good crop prices and we will turn this thing around in a very short time.

Thank you for the opportunity of expressing my views and opinions.

Senator **Grassley**. Thanks to all of you very much. I might say also that each of you in your statement addressed a lot of the questions I was going to ask. I still have several but not quite as many as I originally thought I was going to have. I would like to ask Ragan what he thinks will happen to himself in regard to this new tier structure interest rate situation.

Mr. **Brock**. I have not felt it out completely yet, but I have the feeling that I might enjoy a half a percent less interest rate at best. I was told by the president of the association that I would rank—I asked him on a scale of 1 to 10 how I would fit in with the average stockholder borrower and he assured me that he thought I would be—on 10 being the worst that I would be somewhere in the 3 or 4 area, but I think that's about all it will come through for.

The thing that I would like to emphasize to you, Senator, and I certainly want to commend, I think you have a wonderful opportunity here to do something for agriculture and the stockholders here this morning. I think you have witnessed some of the problems that have created the lack of credibility within the stockholder system in that we have heard some things this morning. I was sorry that Mr. Duncan left because I think this is one of the problems.

I think you witnessed here this morning two people from the Land Bank in Omaha and I think it's a different situation than you witnessed a year ago because I think—I think that Mr. Mullins represents the stockholders well and Mr. Stinson both. I think the attitude has changed in the last year and I think, as someone said, they are trying diligently to meet the challenge.

One of my concerns is, Senator, and I don't know whether I'm correct or not, but I have a feeling on the part of the Farm Credit Administration that there may be that desire to punish the Omaha district because of some mistakes made in the past. And I'm fearful that those mistakes if they were made, and I'm sure there were many mistakes made, were probably made by people that are no longer with the system, that the stockholders are going to pay the price and I think that's wrong.

I said a year ago when I testified that I thought probably only Congress could salvage what's left of the Farm Credit wreckage. I say now it's my firm conviction that congressional action is needed immediately to stop the continuing financial deterioration of many borrowers by the high interest rates dictated by the FCA.

If this is the intent of the Congress, if the intent is to do something, I think they should do it now because the people that are paying the higher interest rates are continuing to believe, and I think that there is a misconception within the system, that the good borrowers have not left yet and I think a high percentage of them have already gone. Thank you.

Senator **Grassley**. Dean, if I remember your testimony right, I think you referred to something about the fact that there was a poll taken by Omaha that 75 percent of the stockholders in that poll said that everyone should share equally in the interest rate reduction. I would like to have your guesstimate or your analysis of why you think Omaha implemented a tier structure for interest rates, particularly considering the poll.

Mr. **Adams**. I think possibly that this is a goal of the Administration, plus I think this is what had to get through to get through Farm Credit Administration. I have talked to Mr. Duncan. I have talked to Mr. Wilkinson on the phone many times and they definitely have been very strong for a multiple rate reduction—I mean interest rate. They just said that one interest rate would not fly, that they needed at least two, but now we've got five.

Senator **Grassley**. Ragan, about this application for interest rate reductions, do you see this in any way as a way to get information on stockholders in a cheap and easy fashion when the vast majority will enjoy very little or no relief as a result of this tier rate?

Mr. **Brock**. I can't be completely at odds with the purpose of it because as you well know the FCA has said that Congress has said to come back to the Treasury when their resources have been depleted. And inherent in that it seems to me is that the Credit System itself has to be able to justify or point out to the Treasury what kind of shape it's in.

As you well know, loans made to land bank borrowers for a 35-year loan, the bank has no way of knowing the vulnerability to losses during that 35-year period until payments aren't made. So as a result of that I can see some justification of if they have to come to the Treasury and say, "We are depleted."

As I have been told Congress dictated that before we can come back to the Treasury and ask for financial aid that they have to be assured that all of the resources within the Farm Credit System have been expended before there's any hope of getting any Government help. If this was true I know of no other way for the Farm Credit System to prove to them what kind of shape they are in.

Senator **Grassley**. Mr. Corum, is it true that the Capital Corp. seems to be more cooperative than PCA's in helping work out problems? And if that would be the case, what is your judgment about whether or not the rest of the system can be that flexible and maybe even some suggestions on what needs to be done to get the rest of the system to act in this way?

Mr. **Corum**. With respect to question one on the Capital Credit Corp., I am comforted by the Congress' enactment of its flexibility right into the Farm Credit amendments of 1985. Certainly the flexibility is there including changing interest rates which does not appear in comparable sections for the banks or the associations. So, yes, there should be flexibility.

Whether there is, indeed, I have had only one occasion to come in contact with them on a practical basis and I'm waiting to see if they are indeed flexible. I can't say yet. Certainly they have the authority to do it. The other institutions of the system in my opinion, Senator, do have the same flexibility. In fact, it's a mandate and I'm disheartened by hearing some of the testimony this morning about forbearance.

It seems to me they are cutting away from what's in the Federal regulations now, 1045, section 1045 on the three tests of whether there ought to be forbearance. They can do the same things, through forbearance and the question is, you know, are they motivated to do it? How much more does it take from the Congress to motivate before they will start doing that?

Senator **Grassley**. Dean, what is the situation on this new total disclosure policy for sitting Federal board members that are running for reelection?

Mr. **Adams**. Disclosure policy the way that it has been interpreted by FCA is that if you have got a vulnerable loan and it doesn't mean that you ever missed a payment, if the debt to asset ratio has changed to where it looks like we might—to where the Farm Credit System might lose some money on that loan, then you have to go through a full disclosure. That has caused lots of directors not to run this year. And the ones that are running have to be pretty strong. And it also goes back the way I understand it that if you have your name on with a relative, it goes back that you have—it brings the relative in if your name——

Senator **Grassley**. But new candidates don't have to.

Mr. **Adams**. Well, I think the new candidates would if they had to, but it's mainly——

Senator **Grassley**. But they don't have to, I mean, under the rule, right?

Mr. **Adams**. I'm not sure. I don't think you're going to—I don't think they know as much about the new candidate. This is my gut feeling. They don't know as much about the new candidate as they do about the directors.

Senator **Grassley**. Who is requiring that policy, the FCA or Omaha?

Mr. **Adams**. Our district is requiring it from interpretation of the Farm Credit Administration. That's my understanding. That's their interpretation from FCA.

Senator **Grassley**. Jim, could I ask you, Jim Mullins, if it's an Omaha requirement or is the FCA requiring Omaha to do this?

Mr. **Mullins**. Disclosure was a part of the law. Now, how that disclosure was going to be interpreted and what those regulations are has risen by the Farm Credit Administration what those regulations are. As far as disclosure, it does apply to current director and it also applies to new potential directors, any candidate.

Senator **Grassley**. Any candidate for reelection or election?

Mr. **Mullins**. Yes. As a matter of fact, current directors——

Senator **Grassley**. That applies even if they haven't missed a payment?

Mr. **Mullins**. Yes. However, the only ones they are giving full disclosure on, Senator, in my understanding are those loans that they have been interpreted to be less than fully collected or that loan that may have been made under conditions different than have normally been made. Then those have involved not just the individual but any relative of that individual who also has a loan in those categories. That's the way it has been interpreted through Omaha by the Farm Credit Administration.

Senator **Grassley**. Ragan, do you have any views whether or not this is discouraging participation in the electoral process?

Mr. **Brock**. Yes; I certainly do. We have an instance on our board where Eugene Mann from Poweshiek County has never been delinquent, he has never missed a payment and yet this disclosure came out before the electorate which I think will hurt him terribly in the election that's being held this week because I'm afraid it's going to be—have a negative aspect on his running.

Senator **Grassley**. And it's keeping the otherwise qualified candidates from may be even applying to run?

Mr. **Brock**. Our system allows a nominating committee which is appointed the year before to contact members for the purpose of running for the board. They had a very difficult time this year—in fact, in one county they couldn't come up with any stockholders that were willing to place their name on the ballot to run for director. It has had a tremendous effect.

Senator **Grassley**. We have to wait a minute for the score keeper to change her machine.

[Recess taken.]

Senator **Grassley**. Just in case I didn't make this clear, we do have a shorthand reporter here taking everything down and there will be a printed record of this available if anybody is interested in getting it. I also need to probably announce that we invited people to participate, but we do not preclude anybody who has got a short written statement that they want to submit for the record. We would be happy to receive that. I say short. I'm not saying how many pages, but don't submit volumes. If you have got anything to offer to this subcommittee in the say of testimony, all you have to do is just submit it to my office and we will see that it's included. That should be done within 15 days, though. Ragan, or were you done?

Mr. **Brock**. Well, the last comment I had was that I felt that this has had a tremendous effect on people wanting to be involved in the serving on boards. And I kind of go back to what I think you were alluding to a while ago. I'm at a—I have a problem with this putting a borrower in a negative position when he or she has never missed a payment because when it all boils down, it seems to me that any loan is a good loan as long as payments are made and I have a problem with this trying to determine—projecting ahead whether a loan is going to be costly to the system or not.

Senator **Grassley**. I have just two questions left. The first one will be to Mr. Westfall. You mentioned in your statement some of the steps that you have taken to get control back of your own institutions. I understand you fired a president in the process. Why was he fired?

Mr. **Westfall**. Trying to be a strong arm bully in so many words. His policies were going down the wrong way. We just kind of got our neck bowed and you just can't exist. Then when he raised the—of course, the district board had part of it—raised the interest rates at the same time, why, we just were up in arms and finally we got the job done.

Senator **Grassley**. Then to Mr. Brock I would like to ask, about a meeting on August 28 to discuss the possibility of holding another merger vote this fall. What happened at this meeting?

Mr. **Brock**. There was really nothing said about the merger. And this is just a personal account on my part, but I have a feeling it's a moot question as far as it's kind of like realigning the deck chairs on the *Titanic*. I'm not sure that they're going to ask for that at this time.

Mr. **Westfall**. Senator, may I say something? It seems that the FCA salvation of this system is restructuring of loans and the tier system. I can't understand how when we're only allowed to reduce our portfolio by half a percentage point—it's not going to affect too many people. Our good borrowers are already gone. They're not going to leave. They are gone. When you restructure these loans, it's going to take in such a small percentage of farmers. If it would take in a much bigger percentage, I'm talking about people such as me or Mr. Brock and so forth, it might help. But it takes in a very small percentage of people.

Mr. **Brock**. Senator, could I ask you one question?

Senator **Grassley**. Yes.

Mr. **Brock**. Is my interpretation correct that the Farm Credit System is to be a strong arm bully in so many words? His policies were going down the wrong way so the Farm Credit System was told to go back, get their house in order, use their reserves and then come back to the Treasury when they were exhausted. Am I correct to that point?

Senator **Grassley**. Well, at least the latter bottom line is correct. I think the theory of the legislation on access to the Treasury and at the cost of money to the Government is that the reserves within the System be used before there's access to the Treasury. Of course, it's not even automatic that that's going to happen, but that's a necessary precondition for the Secretary of Treasury and whoever else is involved to consider it.

Mr. **Brock**. My final question then is, what is your opinion that if this indeed does happen, the System allows the loan loss sharing agreements to work within the districts, we come to the Treasury, our leadership comes to the Treasury and says, "We have used our resources," what is your best guess then as to what Congress' intent might be? Is it simply to allow enough infusion of money to keep the System alive or will it translate into help for the stockholders out of the districts?

Senator **Grassley**. Personally it would have to be the latter and I suppose that's why I didn't vote for the bill in the first instance because I didn't think it guaranteed enough for the individual stockholder. But I don't know whether I can speak for my colleagues. I think that it's a whole new ball game and not as muddy as the issue was as we rewrote the law last year.

You know, focal points weren't necessarily very clear last year and the process was hurried up for getting that legislation adopted, one of the few bills of this controversial a nature to be treated this way. It was considered under debate restrictions. Most of the time that doesn't happen in the Senate. We were up to a deadline of adjournment and all those things just did not allow the really key points I wanted to address to be brought out.

I would expect that the very pinpointed issue that you raised was under what conditions will Congress as a whole help, as an important issue? My bottom line desire is seeing that the help does filter down to help the individual farmer.

I guess I will ask this panel to leave the table. I thank you very much for your cooperation and particularly all of you being busy people in your own right, farming or legal advice, it's really beneficial to the subcommittee that you would come.

I would now call the third panel. The witnesses that we have this time are Tom Huston. He's president of the Columbus Junction State Bank, but everybody in Iowa knows him as a former Iowa superintendent of banking. And we also have Leslie Miller of the Davis County Savings Bank in Bloomfield and she is chairman-elect of the Iowa Bankers Association Agriculture Committee.

So now I want to thank both of you for coming to discuss commercial lenders' efforts to cope with the farm crisis. I think I will call on Leslie to begin with.

STATEMENTS OF A PANEL CONSISTING OF THOMAS H. HUSTON, PRESIDENT, COLUMBUS JUNCTION STATE BANK; LESLIE S. MILLER, DAVIS COUNTY SAVINGS BANK, BLOOMFIELD, CHAIRMAN-ELECT, IOWA BANKERS ASSOCIATION AGRICULTURE COMMITTEE

Ms. **Miller**. Thank you, Senator Grassley. I do want to thank you for the opportunity to present a commercial lender's viewpoint regarding the farm debt crisis and some of the comments I would like to make are regarding what commercial banks are doing to help their customers survive this crisis. I would also like to take a chance and make some suggestions for some changes in some current Federal programs that would facilitate in restructuring the farm debt.

I have prepared some extensive written material which I would like to enter into the record at this time. However, for the purposes of time I will just merely paraphrase portions of that text.

Senator **Grassley**. Yes.

Ms. **Miller**. The lenders in Davis County, Iowa have had the opportunity to be somewhat on the cutting edge of the farm debt crisis. We fell into that role largely as a result of the drought that occurred in 1983 in which our farmers managed to harvest only 20 bushels of corn per acre and 17 bushel of beans per acre. This shortfall in crop income dumped tremendous debt burdens on our farmer borowers. As a result of that we were forced to deal very quickly with the farm debt situation.

The experiences we have had in doing so have taught us that there are some programs that do work and some that don't. I think most commercial bankers are trying to take advantage right now of what few programs do work.

Bankers are involved with mediation negotiation regarding farm debt. They are involved with charge-offs or write-down of excess farm debt and they are also involved in trying to do some restructuring through the guaranteed farm loan programs as well as working with the interest rate buy-down programs to reduce interest rates to their borrowers.

I think some of the statistics that we see in the State will verify the fact that the commercial bankers are participating very actively in these programs. For example, if we look at the State interest rate buy-down program, the figures as of August 8 show that of the 130 participating lenders, 129 were commercial banks and only 1 was PCA. If we look at the Iowa Farmer/Creditor Mediation Service's statistics, for their first approximately 1,500 requests for mediation, over 1,200 of them were from the Farm Credit System with the balance spread between commercial banks, insurance companies and other creditors.

I think that indicates that commercial bankers have been doing their mediation and negotiation all along and were not waiting until law forced us to take these steps. I also think commercial bankers have been charging off debt in a larger proportion than any other lender. I think an example of this is our $387 million in loans that were charged off among Iowa banks in 1985. This is a seven-fold increase of the $55 million that was charged off in 1982.

Further for the record this amounts to a 3-percent portion of our total loan portfolio being charged off. What that means to a bank and what many people don't realize is that when 3 percent of a banks loans are charged off as lost, it's the same thing as if a bank earned 3 percent less interest on all the loans that were paid.

I think this is a very significant figure when you compare it with some of the States that surround Iowa. Illinois banks only charged off 1.02 percent of their loan portfolios. Missouri banks charged off 1.24 percent. Minnesota banks only charged off 1.22 percent. So the recognition of bad ag debt and the write-off of bad ag debt has been occurring in Iowa at a far faster pace than the surrounding States.

I think it's obvious what this is costing us in terms of bank failures. We've seen record bank failures over the last several years, but we have also seen a not so obvious sign of the losses and that is the subtle increase in the interest rate margin that is being charged on farm loans. What I mean by that is we have seen the amount that banks charge on loans to their farm customers increase in proportion to what they are paying on their deposits.

In doing this banks are trying desperately to cover some of the losses that they have faced over the last several years, trying to keep their capital preserved so that the bank does not fail. The banker ends up walking a very fine line. On one hand he has to be forgiving of the debt that cannot be serviced and try to write down interest rates to allow the farmer borrower to survive. But on the other hand he has to keep the bank strong because we have seen very graphically what happens when a bank fails and FDIC takes over.

I think another indication of the farm debt write-off is very obvious in our communities at large. Working with Iowa State University and using an economic input-output model that they have, we have shown that for every dollar of farm debt that is written off as lost to a creditor, there is another dollar in indirect loss that results.

What this means is that for $100 million in farm debt being written off, $200 million is the cost to the State in terms of economic loss.

Over 4,500 jobs will be lost in the State for every $100 million in farm debt that is written off. These numbers are very hard not only for our State economy but our rural banks and our rural borrowers to swallow.

I think in spite of those figures we can say that Iowa bankers are still trying very hard to work with the tools that we have been given. I think we could work more effectively with these tools if there were some changes made.

I think of particular note is the Guaranteed Loan Program. That by and large is the best tool the bankers have to cope with the farm debt crisis. However, a recent survey of bankers by the Iowa

Bankers Association shows that there is still a large degree of doubt amongst bankers that the Government will actually honor those guarantees if a loan goes into default. I don't know of any specific way that we can reassure those bankers that the Government will stand behind its guarantee.

Suggestions that have been made include the possibility of holding joint lender sessions with FmHA and commercial lenders in attendance so that the same kind of education and communication that involves the Guaranteed Loan Program is distributed to everyone at the same time.

Other suggestions are the fact that we might form a State appeal board whereby FmHA personnel, commercial bankers, Farm Credit System people, and farmers form part of an independent board that review any disputes that might arise involving a guaranteed loan. This might help reassure bankers that they will, in fact, have a fair sounding board to hear their grievances if there are any disputes. By the same token it should help assure FmHA that they will have a fair sounding board as well.

Other Government programs that have proven particuarly harmful involve in particular the farm bill and some of the implications that that bill has put together. For example, as you are well aware, we are facing a 300-million-bushel shortfall in storage this fall of our corn crop. What that will result in is many farmers dumping corn on the market at whatever price the market will bear, $1.25 a bushel, $1.00 a bushel. We have no idea how low the market will go. This is in stark contrast to the $1.84 that many lenders were anticipating their farmers being able to receive from the Government Loan Program.

The problem that we see here is the fact that ASCS has simply neglected to realize the fact that they were facing massive forfeitures of corn and take action to alleviate that situation soon enough. The effect of that inactivity will be the fact that bankers in the future and farmers in the future will not be able to rely very effectively on Government price supports as some kind of price protection for our crops.

In the past we have relied on those as a measure of trying to control the risk that is involved with financing highly leveraged borrowers and the result of this fall's activity and the potential for selling corn at a much lower rate makes us very leery of trying to rely on that in the future.

Other things that we keep in mind as we look at trying to work our highly leveraged borrowers is the fact that there is continuing new legislation that makes it more difficult for commercial bankers, commercial lenders to work with farmer borrowers in the way that they have in the past. We can't forsake our farmer borrowers. In past years they have made 40 to 45 percent of the total loans by Iowa banks in the State.

However, what we do recognize is that whenever there is a law passed that restricts our ability to work with those borrowers there is an increase in risk. What often happens is that increase in risk is passed on in the form of a higher interest rate or sometimes a loan is not made to a marginal borrower because the risk can't be controlled sufficiently.

Other measures that bear looking into regard the PIK certificates or the generic grain certificates the Government has issued. At this point in time there is no way for a lender to put a lien on those certificates. The ASCS, through Commodity Credit mandates that they may not be subject to any lien. The result of this is that again a marginal borrower may not qualify for credit because a significant portion of his income cannot be covered by standard security agreements.

What we also run a danger of is the fact that FmHA right now is applying for setoffs on those certificates. What this would mean is that a borrower who is delinquent with FmHA, could have FmHA step in and take those certificates or take the value of those certificates ahead of a commercial lender who might have financed the crop inputs for that farmer for that year. Again, what you wind up doing is having a decrease in money available for marginal borrowers when there's risk that that may occur.

Senator GRASSLEY. Could I ask you to summarize and finish so I can get to Mr. Huston?

Ms. MILLER. I think that bankers and farmers cannot fight their way out of the farm debt crisis unaided. I think it's largely because the farm debt crisis is now a farm profitability crisis as well. We are well aware of the fact that the bottom of the crisis is totally dependent on the bottom of the corn market. The lower the price of corn goes, the longer the problem will persist.

However, I think the problem may be modified somewhat if bankers are allowed to work unrestricted by harmful legislation and if they are aided by some additional Government programs. New legislation, the unreliable programs, they not only hinder our ability to finance these marginal borrowers but also hinder our ability to service our communities as well. So I think the survival of our communities, our banks, and our farmers lies largely in your efforts to control and answer some of the problems that are facing us right now.

Senator GRASSLEY. Tom.

Mr. HUSTON. Senator Grassley, my name is Thomas H. Huston. I'm president of the Columbus Junction State Bank, Columbus Junction, IA. Leslie and I discussed before today what part I would take and what part she would take. I will be on different subjects, so at least we won't be repeating each other. I certainly support her in her testimony.

I also want to thank you for holding these hearings and suggest that you hold hearings such as this more frequently so that you can even be more current as time goes on. My remarks are my opinions. I believe them to be accurate.

Your letter of August 19 asks what the Farm Credit System, commercial banks and the Farmers Home Administration are doing to resolve the farm credit crisis and what actions are necessary for family farmers to receive credit next spring. You also are interested in possible changes the Federal Government could make in their policies to facilitate farm debt restructuring.

My first statement, Senator, which is not new to you is that banks, FmHA and the Farm Credit System cannot resolve the farm credit crisis as they did not cause it any more than did the farmers cause it. The regulators of financial institutions did not cause it either. The cause of this crisis in agriculture is quite a lot the same as the crisis in textiles, lumber, steel, auto, and farm equipment manufacturing and oil.

Economic forces that have responded to U.S. Government policies and policies of other countries bring these fruits and they are bitter instead of sweet. These problems have been building for years and cannot be laid at any one administration's doorstep nor on any one political party. We all have played our parts over time and have reacted to the conditions that have now changed and we must stand our responsibilities.

Now to talk about the two items that I wanted to spend some time on which are talked about at least in the newspapers and other media, capital forbearance for commercial banks. It is my understanding that very few plans for capital forbearance for banks in Iowa have been submitted. I am told about 12 plans at most for the State of Iowa and none have been approved as of this date to my knowledge. It seems that banks with low capital and reserves to total asset ratios that need forbearance are either unable to put together satisfactory plans or if they have a possible plan they are deemed to not deserve approval.

I am not aware of any effort by regulators to help devise an acceptable plan and it appears that attorneys and accountants along with bankers are trying to make the plans acceptable. Capital forbearance is relatively new to bankers and bank regulators and it has not been easy for either to know how to proceed. According to some public written information available, one could get the idea that 6 percent is a minimum satisfactory capital figure for banks. That figure by the way is higher than for savings and loans and most other institutions.

What is being asked now, however, is 6 percent plus an adequate loan loss reserve that could run several percent more which really means most banks are expected to have 8 percent capital or more. Of course, it is the bank that is having difficulty that is short on capital usually and it is the same bank that is being asked for the higher figure.

Iowa wants all banks to have 8 percent. I put that policy in effect myself, but there are many banks that are in the 7 to 8 percent brackets. At the present time there are 32 State chartered banks with capital and reserves below 7 percent. When I became superintendent of banking for the State of Iowa in 1975, there were over 100 State chartered banks with capital and reserve ratios of less than 7 percent and through diligent effort by the Iowa Department of Banking when most other regulators actually did not help us and, in fact, many bankers made fun of us, we were able to reduce that by 1980 to just a few banks below 7 percent. It is that heavy capitalization that has kept Iowa from being even more devastated. What is adequate capital for banks has been argued for years by many and as far as I know there is no answer other than what people demand.

My second point that I was to discuss with you in my prepared remarks is FASB 15, Financial Accounting Standards Board policy No. 15, and in my prepared remarks it's a typo. This accounting of policy was adopted on or about 1979 according to what I understand. It was devised as a method to handle the financial crisis of

New York City. It was not even generally known to bankers or most bank regulators until the spring of 1986. Few bankers know how to use it and regulators are somewhat skeptical.

The policy is deemed to be sound by the CPA and Accounting Standards Board and could be used more if accountants, bankers, and regulators did know more about it. Any policy like this that has not been used in banking can cause bank regulators to add additional requirements or stipulations that can render the policy useless.

Time will tell how helpful FASB 15 is or can be. It is consistent, however, with Federal policy because it requires true debt restructuring which is one of your topics at this hearing which is needed for many farmers and other businesses at this time. I will be happy to respond to any of your questions. Thank you.

Senator GRASSLEY. Well, thanks to both of you very much. I would like to ask one or the other of you, and it doesn't matter which one, whether or not you agree with Marvin Duncan in what he said today that land values are stabilizing in Iowa and whether or not you think things are starting to turn around as he indicates.

Mr. HUSTON. I will pass to Leslie.

Ms. MILLER. I stand on my remark that I made earlier, that I feel that the bottom, not only in land markets but in the debt situation as well, is very dependent on the price of corn. We have seen in Davis County, and again I think that we're probably 6 to 12 months ahead of the rest of the State at large, we have seen a stabilizing of land values, but they are at very, very low levels.

Mr. HUSTON. I would like to add, Senator, that I do not think the bottom of land prices is here.

Senator GRASSLEY. You both mentioned high loan losses as a primary cause of high interest rates charged by Iowa banks. I would like to refer to what I have referred to once before, a survey done by the Reserve Bank of Chicago which found that interest rates in Iowa were on the average 1.2 percentage points higher than interest rates in the surrounding States.

I would like to read from that report, "The deterioration of loan portfolios at many Iowa agricultural banks has maintained upward pressure on loan rates in that State as affected institutions attempt to overcome losses. In addition, problems in the loan portfolio of the Omaha Farm Credit System's bank which serves Iowa have limited competitive pressures on farm loan rates."

Do you agree with this assessment that in addition to their high loan losses, Iowa banks have kept their interest rates high because of the lack of competition from the Farm Credit System and that there really isn't any incentive for banks to lower their rates?

Ms. MILLER. I go back to the figures that I quoted earlier. Let me try to use an example. If the loan losses on the average in Illinois are around 1 percent of their portfolio and let's say banks in Illinois are charging 11 percent on the average, what that means is if you take that 11 percent, subtract off the 1 percent for loan losses, you're looking at about a 10-percent net to those banks.

Iowa banks on the other hand have a 3-percent average loss, so even if banks in Iowa are charging 1 percent higher than those Illinois banks, say they're charging 12 percent, by the time you take off that 3 percent we're only netting 9 percent. So in actuality we are on the average squeezing our margins possibly thinner than banks in surrounding States are just to try and get the interest rates down to help the farmer survive.

Senator **GRASSLEY**. So then basically the Federal Reserve Board is correct that lack of competition is the reason for Iowa banks to be charging higher rates?

Ms. **MILLER**. I know we are trying to charge as low an interest rate as we possibly can and to remain solvent. I think many banks have been lowering their interest rates recently and are all working to try and get their interest rates down as quickly as they can, but our competitive factor is amongst other commercial banks rather than the Farm Credit System as a whole.

Senator **GRASSLEY**. Question to Tom. Do you think that Iowa banks could lower their interest rates if Iowa banks had access to the national capital markets like the Farm Credit System does?

Mr. **HUSTON**. Yes, they could, Senator. And I was in a discussion about all this this morning.

Senator **GRASSLEY**. Would it be beneficial to Iowa banks if they did have that access?

Mr. **HUSTON**. Yes. We fund the Iowa banks on deposits basically from Iowa, basically from the communities in which those banks are located, and they do not have access to the money markets, small banks in Iowa. And all banks in Iowa are classified as small. They can't and don't use the Eurodollar markets.

We hear all the time, of course, about how the discount rate is lowered by the Federal Reserve. Very few banks in Iowa borrow money from the Federal Reserve. Very few have that kind of money in their bank to loan. The interest rates are much higher.

I would not say that maybe the interest rates are as tough as some that I heard the Farm Credit System talking about, some of their bonds, but, of course, I don't know what their total mix of money is and, of course, we have to look at the total mix of money we have on the deposit side. But, yes, I think a similar method to raise capital for Iowa banks would be helpful.

Senator **GRASSLEY**. Leslie, I would like to have your reaction to what Mr. Mullins said about that there's not a necessity for a secondary market for farm loans.

Ms. **MILLER**. I feel there is a necessity. One of the proposals I submitted with my written text brings that point to bear in that if banks could tap that national market as a source of funds, we would stand in greater competition with the larger commercial banks that have a more varied source of funds and do have lower interest rates than what our average rural banks are charging right now.

Those funds would not be subject to reserve requirements. Our correspondent banks have us hold back 12 percent of our ledger balances for reserve requirements. The Fed above a certain level asks for 12 percent for reserve requirements, so those funds from the national source would not be subject to that.

They could also be gathered in at a much lower rate than what we are paying right now to our local depositors and they could be dependable in that if we for some reason had to drop our rates to such a level that we had local depositors leave the bank, we would know that we had another source of funding that we could rely on to fund our farm loans.

[Submitted material follows:]

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August 30, 1986

Senator Charles E. Grassley, Chairman
Subcommittee on Administrative Practice & Procedure
Committee on the Judiciary
United States Senate
Washington, D.C. 20510

Senator Grassley,

I appreciate the opportunity to present a commercial banker's views on the farm debt crisis and some of the changes necessary to government programs to facilitate debt restructuring.

As an agricultural loan officer working for ten years in Southeast Iowa, I have had ample opportunity to experience large fluctuations in farm profitability. We had good harvests and average prices in 1978, 1979, and 1980. Then there were poor crop years in 1981 and 1982 when we experienced 50 and 100-year floods, followed by a devastating drought in 1983 when Davis County farmers harvested less than 20 bushels of corn per acre. The build-up of debt due to the losses of these years, compounded by the high interest rates brought on by Federal Reserve Chairman Volker's change in monetary policy, led to the closing of a bank in our community, the Exchange Bank, in 1983. It also contributed to the closing of a bank in a nearby community, the Peoples National Bank of Albia, in early 1986.

These experiences, as well as those more recently gained as Chairman-elect of the Ag Committee of the Iowa Bankers Association, have allowed me to view the entire spectrum of the farm debt crisis. I know well the frustrations of a lender who has helped a farmer put together a survival plan only to have it fall apart because the Administration does not adhere to the farm bill as written, or because the worst storage crunch in history will make it impossible for farmers to put their grain under loan.

I also know the frustrations of a banking industry that has tried to help formulate guidelines for debt restructuring, mediation, improvements in the FmHA guaranteed loan program, and capital forebearance, only to be stymied by impractical compromises or other legislation that further increases the risks of lending to farmers.

The new laws, the farm bill, and administrative policies have fallen short of supplying us with the tools we need to help our farmer borrowers and ourselves survive this crisis. What we have instead is the typical "bandaid approach" of a myriad of programs that are never very successful, due largely to the fact that basic principles of lending and/or farming are often ignored in putting these programs together.

The lack of attention to these principles is graphically illustrated by some of the legislation that has been passed in recent years. Much of this legislation deals directly with a lender's ability to secure loans, and in most instances impairs this ability. This increases the risk associated with the loan. Since a lender's primary responsibility is to quantify risk, the increased risk results in an increased interest rate to the borrower.

In order to fully comprehend the effects of the new legislation, it is necessary to examine it more closely. The most onerous of these laws is the law concerning the sale of farm products, more commonly referred to as the "double jeopardy" law. This law is particularly difficult for Iowa bankers as they will soon be forced to comply with the provisions set forth under Sec. 1324 of the Federal Food Security Act of 1985 and those set forth under Senate File 2050 which is an amendment to Section 554.9307 of the Iowa Code.

Under the double jeopardy law, the federal government has given the states two choices in complying with the law. The first choice involves the establishment of a central notification system. However, the guidelines for this system are so restrictive that only one state, South Dakota, now complies. The other states are forced to pay the overly burdensome cost of setting up a system like South Dakota's or else may opt for the second alternative of pre-notification.

In Iowa we have operated under a system of pre-notification for over a year. During this time we have heard many complaints by bankers, buyers of farm products, and the farmers. Bankers have felt obligated to ask for jointly payable checks on all customers so as not to disclose the financial condition of any one borrower. Sale barns and grain elevators complain of the extensive lists that they must go through and are fearful that they may miss a name. Farmers are weary of circumstances where they may sell one cull ewe for $25.00 and have to run to the FmHA and the bank for endorsements before they can deposit the check.

In order to spare many of the states from similar experiences, and Iowans from a continuance of these experiences, I would like to see changes made in the guidelines surrounding central notification. Possibly the best solution would be to leave it up to the individual states so that each may take its own approach to providing a type of central notification in as efficient and cost-effective manner as possible.

It is unfortunate that a law with such a profound effect on ag lending does not really deal with the crux of the matter - that being the problem that arises when someone sells farm products that serve as collateral and intentionally defrauds the bank by not applying the proceeds to his loan. Under the new double jeopardy law, these people will still be able to defraud the bank. Although they may face some criminal penalties for doing so, these penalties are not severe enough to halt the problem and do nothing to help recover diverted funds.Thus, the most effective way of dealing with the problem may be to enact very tough penalties for those few that intentionally defraud their creditors, rather than put the burden on the honest majority.

In addition to double jeopardy, several state laws have increased the risk of ag lending in Iowa relative to surrounding states. The most notable of these are the mandatory mediation law, the foreclosure moratorium, and the requirement of a 45 day right-to-cure period on ag real estate loans. These laws have caused many out-of-state bankers to comment that they would never make a loan to a farmer in Iowa. However, Iowa bankers cannot shut the door on agricultural lending since ag loans now comprise approximately 45% of the loans made by all Iowa banks. Thus, bankers are forced to recognize that there is a higher degree of risk in making loans to agriculture and must therefore price their loans accordingly.

The additional risk created by these new laws may be increased by new bankruptcy legislation. In an effort to minimize this risk, and thus minimize the increase in interest rates (or the decrease in loans made to marginal borrowers), I would like to propose adoption of the amendments outlined in attached "Exhibits 1-14.5".By incorporating the amendments into the law, a more equitable situation is created for the creditor and the borrower. Thus, lenders will be less prone to deny credit to marginal borrowers or charge an increased rate of interest to farm borrowers due to the new bankruptcy laws.

In addition to the legal barriers that Iowa bankers are facing, there are barriers caused by inadequate government programs. The most notable of these problems have occurred with the FmHA guaranteed loan program and the farm bill.

In a recent survey of Iowa bankers, many bankers expressed a total lack of confidence in the FmHA's willingness to honor guarantees on loans that went into default. Bankers were also concerned with the fluctuations in collateral values between each county, the lack of information regarding program changes, the impracticality of many program requirements, and the amount of time it takes to get a loan application processed.

Some of the problems cited - such as the repayment requirements on interest-rate buydown loans - have been corrected. However, there is still a need for common education and communication to solve the problems caused by inconsistency and changes in the program. This may be dealt with by holding periodic joint lenders meetings on a quarterly or semi-annual basis in order to keep all lender apprised of the same information.

The problem of a lack of confidence is not easily overcome. Time and experience may help resolve this matter. However, many bankers are not now using guarantees because of this lack of confidence. Thus, it may be beneficial to establish a state appeal board in each state, made up of FmHA personnel as well as Farm Credit lenders and commercial bankers, in order to assure lenders that an impartial board may examine guaranteed loan problems. This board would have the authority to settle disputes that may arise from time to time regarding collateral valuations, loan servicing, and liquidation procedures. With this assurance of fairness, bankers may feel more comfortable, and may make greater use of the guarantee program to help their customers.

The present farm bill holds many pitfalls for lenders and their borrowers. Nothing illustrates this more graphically than the problem now faced by Iowa farmers due to a lack of storage space available for the 1986 crops. This will cause many farmers to sell their corn on the market for $1.25 (or less) per bushel instead of placing it under a government loan at $1.84 per bushel. Part of this storage problem is caused by the ASCS not recognizing that it would face massive loan forfeitures on the 1985 crop and not acting quickly enough to locate storage for the forfeited grain. This has left many farmers with bins on their farms still filled with the government's grain and no place to go with their 1986 crop.

Because of the farmers being forced to sell their grain for almost 60¢ per bushel less than the loan rate, many will default on their loans. This could further aggravate the farm credit crisis, and in itself may be enough to extinquish the last remaining equity of many farm operations, making it impossible for them to obtain credit to go through another year.

Another problem with the farm bill lies in the handling of the PIK certificates (generic grain certificates). It is readily apparent, and has been for some time, that the administration intends to make most of the deficiency payments, conservation acre reserve payments, dairy termination payments, and other program payments by PIK certificate. This policy may help us eventually work towards reducing the burdensome oversupply of grain now in storage. However, it may also further endanger the credit of marginal farm borrowers, because a lender may not place a lien on these certificates.

The result of this policy will be that lenders will only lend to those operations that do not require the use of their deficiency payments in order to cash flow. This, in turn, will dry up the funds for marginal borrowers or greatly increase the costs of obtaining them.

Of even greater concern to lenders is the policy that permits the right of set-off by all agencies of the federal government against any farm program payments. Under this policy, it is conceivable that any farmer who is delinquent on his FmHA real estate loan would have to pay his loan current before he repay the creditor who advanced money for crop operating. Should this occur, or if there is any danger of this occurring, no prudent commercial banker will loan that farmer any additional funds. Thus, the net effect would be to put a farmer out of business as soon as he became delinquent on any government loans.

Presently the FmHA is in the process of writing guidelines that will allow them to exercise the right of set-off. This should not be allowed to happen as it will not only violate lien priorities as now determined by the Uniform Commercial Code, but will also dry up credit to those borrowers that may be having problems with FmHA.

In spite of all the problems outlined above, Iowa Bankers have done an admirable job in working through the farm debt crisis with their borrowers. This is readily evidenced by the documented large participation of commercial bankers in the FmHA guaranteed loan programs and the state and federal interest-rate buydown programs. The ability of Iowa bankers to be flexible and to take what steps are necessary to assure survival of the farm operation may be illustrated by examining figures that show that of the first 1500 requests for mediation received by the Iowa Farmer Creditor Mediation Service, over 1200 were from the Farm Credit System with the balance split between insurance companies and commercial lenders.

Thus, it may be concluded that Iowa bankers are recognizing their obligation to their farmer borrowers and their communities. Unfortunately, this has exacted a heavy toll on the Iowa banks. We have all seen the evidence manifested in the numerous bank closings. Other evidence of the fight for survival is demonstrated by the interest rate spreads - the widening of the margin between interest rates being paid by banks and the interest rates being charged on loans. This widening is caused by the need for banks to recover loan losses taken largely on bad ag debt. These losses must be recovered because of the expectations by depositors that for every dollar they deposit in a bank, they will receive a dollar back. Thus, every time a bank has to receive less than a dollar repayment for a dollar loaned, it must make up the difference by increasing the interest rates to its remaining borrowers.

In addition to debt restructuring and mediation (negotiation) banks are also forgiving and charging-off bad debt in record amounts. The call reports for all Iowa banks for all of 1985 show that over $387 million was charged-off by Iowa banks in 1985. This would be approximately 2.92% of the loan portfolio, and the net effect would be the same as all loans earning 2.92% less interest during the year. With this statistic in mind it is very obvious why Iowa banks are fighting for survival. When this is compared to charge-offs of 1.02% for Illinois banks, and 1.24% for Missouri banks,and 1.22% for Minnesota banks it is understandable that interest rate in Iowa may be slightly higher than in surrounding states.

The failure of an Iowa bank to restructure farm debt and remain profitable has very unfortunate consequences for the community surrounding the bank. We have seen the devastation that is brought about by bank failure on two different occasions in Southeast Iowa. Because of this situation, the most frequently asked question in Davis County is "How is the bank doing?". Our loan customers are concerned that we keep a viable, healthy bank in order to continue to service their needs. Our failure to do so would force many of our farmer borrowers to try and locate credit elsewhere - which is not easily done in these times.

Thus, as you can see Senator Grassley, the banker walks a fine line. On one hand he must try and forgive debt and restructure loans to help his borrowers survive. On the other hand he must not forgive too much or he will fail and that would bring even greater problems on his borrowers. But this is not the only concern in our fight for survival. As I mentioned above, there are many other changes needed in government policies and in current proposed legislation in order to help us continue to serve our customers.

In addition to those concerns already mentioned, I would like to add the following proposals that may help our farmer borrowers. One of these proposals concerns opening up the state interest-rate buydown program for feeder cattle loans. As you well know, the Iowa economy has been dramatically impacted by the loss of the cattle feeding industry. To combat this, I would suggest that we use the program to help buy down interest rates on feeder cattle loans where the cattle are fed in the state of Iowa and the owner of the cattle is a resident of the state.

Another proposal I would submit, is allowing banks the ability to obtain funding from a national source, similar to that used by the Farm Credit System. This would allow banks to use funds that are not subject to reserve requirements to buy participations in ag loans. The cost of these funds could be provided to borrowers at a rate substantially less than those funds that are subject to all the reserve requirements, FDIC insurance requirements, etc. A more thorough outline of this proposal is included in attached "Exhibit 15".

Your attention to these matters and your help in resolving these problems will aid in the survival of farmers and the community banks that serve them.

Respectfully submitted,

Leslie S. Miller

Leslie S. Miller
A.V.P. & Ag Loan Officer

EXHIBIT 1

Amend Sec. 10 of H.R.2211 to read:

"Sec. 10. Applicability of Amendment.

(a) This Act is an emergency measure and this Act and the amendments made by this Act shall apply with respect to cases commenced under title 11, United States Code, after the date of enactment of this Act but before five years after such date.

(b) This Act and the amendments made by this Act shall be repealed on the date five years after the date of enactment of this Act."

Comments on Exhibit 1

Present Law: Not applicable.

S.2249: The provisions of the bill expire five years after enactment.

H.R.2211: The bill has no sunset provision.

Proposed Amendment: The proposal follows the Senate bill and provides that Chapter 12 will expire after five years.

Because the bill creates such imbalances in farm debtors' and creditors' rights and protections to the detriment of the creditor, the bill and its impact on both the agricultural and agricultural lending industries should be examined and analyzed after five years. Because the effect could be significant and possibly detrimental to both industries, it is crucial that the subject be revisited. At present, the agricultural industry is in a crisis, this may be quite different five years; and there may no longer be a need to favor the farmer.

It contrast, it may also be that the changes in the Bankruptcy Code force creditors to refrain from agricultural lending, ultimately intensifying the problem rather than alleviating it. Because of the uncertainty of the bill's impact and the possible significant and dangerous consequences, Congress should allow itself the flexibility to reexamine the subject after a few years. This period should absolutely be no longer than five years given that the adverse impact of the bill may be felt very quickly and very sharply.

EXHIBIT 2

Delete "Sec. 1222. Adequate protection." and all that follows under that section.

Comments on Exhibit 2

Present law: Any petition filed under the Bankruptcy Code operates as a stay barring any action against debtors or their property. However, the Bankruptcy Code requires the court to lift the stay unless debtors can "adequately protect" creditors.

Section 361 of the Bankruptcy Code enumerates three examples of adequate protection. The courts have interpreted the "indubitable equivalent" example as requiring that the secured credit be compensated to the extent of its interest in the security and not merely to the market value of the security. Some courts have construed this "totality of interest" factor to include compensation for lost opportunity costs, i.e., the loss of the use of funds the creditor would receive from a foreclosure sale of the collateral.

S.2249: The bill specifies that Section 361 of the Bankruptcy Code does not apply to cases filed under Chapter 12. It limits secured creditors' compensation to adequate protection based on the secured portion of the claim rather than to the "totality of interest" test of present Sec. 361. It also eliminates compensation for "lost opportunity costs" by eliminating the indubitable equivalence standard of present Section 361 and substitutes a reasonable rent test.

H.R.2211: The bill makes no changes in present Code.

Proposed Amendment: The amendment follows the House bill and retains present law on adequate protection.

Adequate protection and lost opportunity costs are important and crucial aspects of the bankruptcy process to creditors. It seems reasonable that if a creditor must forego its right to claim physically the collateral, to be in a position comparable to one as if it had indeed repossessed the property, the creditor needs to be compensated for any amount it could have earned had it actually possessed the collateral. The creditor bargained for this right and the debtor agreed to it when the loan was made. Indeed, the creditor relied on it.

In addition, this adequate protection concept encourages debtors to negotiate and work out debts with the creditors instead of jumping into bankruptcy before it is necessary.

The Senate version eliminates this important and bargained for creditor right and diminishes a debtor's incentive to use bankruptcy only as a last resort.

The Senate version substitutes rental payments, but this substitute is inadequate. It assumes that the only option a creditor has, even if it were to have possession of the collateral, is to rent back to the farmer. This may be true in some circumstances, particularly in a climate such as now where farmland prices are very low and farmlands are not terribly

EXHIBIT 3

Section 1222 of S.2249 is amended to add subsection (c) which reads as follows:

> (c) If the court's order for adequate protection is based on the provisions of subsection (b)(3) of this section, the court may also require periodic interest payments on the principal due and owing by the debtor to the requesting creditor.

Comments to Exhibit 3

Present Law: Section 361 of the Bankruptcy Code enumerates three examples of adequate protection. The courts have interpreted the "indubitable equivalent" example as requiring the secured creditor be compensated to the extent of its interest in the security and not merely to the market value of the security. Some courts have construed this "totality of interest" factor to include compensation for lost opportunity costs - the loss of the use of funds the creditor would receive from a foreclosure sale of the collateral.

S.2249: It provides that section 361 of the Bankruptcy Code would not apply to a case filed under Chapter 12. It limits the secured creditor's compensation to adequate protection based on the secured portion of the claim rather than the "totality of interest" test of present section 361. It also provides that the creditor shall not be entitled to compensation for "lost opportunity costs" by eliminating the indubitable equivalence standard of present section 361 and substitutes a reasonable rent test.

Proposed Amendment: The amendment seeks to give the court the authority to order the debtor to make payments based on the principal due where the court determines that the reasonable rental due under subsection (b)(3) does not adequately protect the secured creditor. There may be situations where the interest accrual on the secured debt from the date of the filing of the petition until the date of confirmation would not be fully covered by the rental payment ordered by the court. This subsection allows the court the flexibility to require "rent plus interest payments" where it determines that the payments are needed to protect adequately the creditor. This "rent plus interest payments" concept parallels section 75(s) of the Bankruptcy Act of 1898, as amended by the Frazier - Lemke Act, August 28, 1935, c. 792, 49 Stat. 943-945, 11 U.S.C.A. section 203(s).

EXHIBIT 4

Section 1222 of S.2249 is amended to add a subsection (d) which reads as follows:

> (d) Within thirty days after a request for adequate protection is filed, the court shall hold a final hearing on such request. Prior to the expiration of the thirty days, the court may, on its own motion or on request of a party in interest, grant one extension, not to exceed thirty days, of the time for holding the final hearing on such adequate protection request.

Comments to Exhibit 4

Present Law: The present Bankruptcy Code does not provide a time limit within which a hearing on a request for adequate protection must be held unless such a request is made in connection with a motion for relief from the automatic stay.

S.2249: No provision. .

H.R.2211: Same as current law.

Proposed Amendment: The proposed amendment requires that hearing on adequate protection be held 30 days after the motion has been filed. S.2249 and H.R.2211 allow the farm debtor 240 days to file a plan before another party may file. Our experience indicates that bankruptcy judges are reluctant to grant creditors relief from the automatic stay prior to the end of the debtor's exclusive period. Consequently, under the proposed bills which greatly extends this period, fewer creditor will file motions for relief from the automatic stay or in the alternative for adequate protection. Current law dictates a time limit within which a hearing must be held on a motion for relief from the automatic stay. However, the law posts no time limit for when a hearing must be held on a motion for adequate protection. Since adequate protection is designed to preserve the status quo between the date the bankruptcy petition is filed and the date the plan is confirmed, the hearing on a request for adequate protection should be held as soon as possible after the filing of the request.

The amendment also limits an extension to hold a hearing to be no longer than 30 days. The extension must be granted within the original 30 day period and may be granted by the court on its own motion or upon the motion of an interested party, after notice and a hearing

EXHIBIT 5

Section 1222(b)(3) of S.2249 is amended to read as follows:

(3) paying to the creditor, within the time established by the court, but not less than quarterly, for the use of farmland the reasonable rent customary in the community where the property is located, based upon the rental value, net income, and earning capacity of the property; or

Comments to Exhibit 5

Present Law: There is no similar provision of the Bankruptcy Code which enables a debtor to pay rent as a form of adequate protection.

S.2249: The bill allows the payment of rent as a form of adequate protection to be paid to the trustee.

H.R.2211: Same as current law.

Proposed Amendment: The amendment provides that any rental payment as a form of adequate protection should be paid directly to the creditor from the debtor. The proposal of S.2249 that the payment be made to the trustee will subject this rent money to the 10% compensation schedule of Section 1203(d). The transaction is a relatively simple one that does not demand the involvement of a trustee and does not justify the expense to the estate.

S.2249 does not contain a time limitation within which the rent money must be paid by the trustee to the creditor. The amendment also provides that the order on this form of adequate protection specify the payment dates for the rental and that these payments must be made at least quarterly.

EXHIBIT 6

Amend subsection (a) of "Sec. 1213. Plan by a party other than the debtor; impairment of claims, post-petition disclosure and solicitation; acceptance" and add after "1125" "and 1126". Delete "and" after "1123" and add ", " after "1123".

Comments to Exhibit 6

Present Law: A class of claims has "accepted" a plan if at least two-thirds in amount and more than one half in number of the creditors voting have accepted the plan. Acceptance of the plan by creditors may be necessary where creditors are not assured certain minimum payments.

S.2249: In the case of a plan proposed by a party other than the debtor, a class of claims has accepted the plan if at least two-thirds in amount and more than one half in number of the creditors, whether or not voting, have accepted the plan. (Although Sec. 1216 (a)(8) regarding confirmation of the debtor's plan alludes to secured creditors' acceptance of a plan, no provision explains acceptance requirements for a debtor's plan).

H.R.2211: The bill retains present law and allows a single standard for voting requirements.

Proposed Amendment: The proposal follows H.R.2211 and preserves the present law. S.2249 greatly curtails the creditor's ability to participate in the formulation of the plan because even a primary creditor's vote would have no weight if enough creditors are not sufficiently interested to vote. Minor creditors may choose to avoid close involvement in the proceeding if the amount owed them is small. This provision thus unfairly and significantly dilutes the input of an interested creditor who may have large sums at risk. Creditors should have some limited involvement in the drafting of the plan as they do at present, but it is justified given the close association of business, credit, and source of income and the large sums creditors may have at stake. The bill should not further diminish creditors' protections than it already has.

EXHIBIT 7

Delete "Sec. 1216. Confirmation of a plan proposed by the debtor."

Delete "Sec. 1217. Confirmation of a plan by a party other than the debtor."

Amend Sec. 1216 to read:

[Insert language of Sec. 1129. Confirmation of a Plan."]

or

[Insert language of Sec. 1325. Confirmation of a Plan."]

Comments to Exhibit 7

Present Law:

CHAPTER 11:

Unsecured creditors who fail to approve the plan must receive the present value of their claim or be paid in full before the debtor may retain property (absolute priority rule).

Secured creditors who fail to approve the plan must receive the present value of the collateral. Payment may be deferred and include interest.

CHAPTER 13:

Unsecured creditors must receive the value of the claim or all of the debtor's "disposable" income during the first three years of the plan. Otherwise, they must receive at least what they would receive under Chapter 7 liquidation.

Secured creditors who fail to approve the plan must receive the present value of their collateral paid over a period of time. No interest need be included.

S.2249:.

DEBTOR'S PLAN: (Essentially Chapter 13)

Unsecured creditors who do not approve the plan must receive at least what they would receive under Chapter 7 liquidation.

Secured creditors who fail to approve the plan must receive the present value of the collateral over a period of time.

OTHER PARTY'S PLAN: (Essentially Chapter 11)

Unsecured creditors who fail to approve the plan must receive the present value of their claim or be paid in full before the debtor may retain property (absolute priority rule).

Secured creditors who fail to approve the plan must receive the present value of the collateral. Payments may be deferred and include interest.

H.R.2211:

The bill retains present law, but permits "family farmers" who would not otherwise file under Chapter 13 to file under this chapter where the plan confirmation requirements are less strict.

Proposed Amendments: The proposals are in line with H.R.221 in that they treat equally plans proposed by interested parties. Our first preference is that the confirmation plans of Chapter 11 apply, given that the creditors need and are entitled to participate in the formulation of the plan and should be assured a minimum payment of debt, as they are in the typical farm bankruptcy case. Creditors have a special interest in a business reorganization plans because, in contrast to consumer bankruptcy cases where income and fund repayment are separate and distinct from the debt, business financing is closely woven into the business operation that provides the source of repayment. Repayment is dependent on the health of the business. Equally, the management of the business, the existing debt burden, future earning prospects, etc. are all critical considerations in deciding whether credit will be extended. Therefore, since the original credit was extended in order to produce the income, it is only reasonable and equitable that creditors should have input into the reorganization process which will reform and reshape the original business entity and determine when, if, and how much creditors will be paid. Requirements that creditors approve the plan or else receive minimum payments provides this creditor participation.

In addition, creditor participation in finding a solution is important when large debts are at stake which, is commonly the case regarding farm debtors. Under these circumstances, debtors should not be the only ones to determine how the business and assets should be reorganized because they are not the only ones with much to lose. A large creditor might also have his livelihood at stake. Indeed, it is hardly unfair in a reorganization procedure to entitle a creditor to at least a minimal return of the debt. Forcing a creditor to take a huge loss could cause the creditor itself to become insolvent especially when its other debtors are also failing in large numbers.

However, if the Chapter 11 plan confirmation requirements are not accepted in the bill then, at the very least, plans offered by debtors and plans offered by interested parties should receive equal treatment. The disparate treatment hardly seems fair, especially given that the bill already awards the debtor with a very long exclusive period to file a plan when all other debtors either have to file the plan immediately with the bankruptcy petition or are entitled to only half the time allotted the family farmer. If the bill is going to change the confirmation requirements so that plans are more easily confirmed, then all plans should be treated the same.

EXHIBIT 8

Amend "Sec. 1201. Definitions" of S.2249 to read as follows:

For purposes of this chapter -

(A) a person engaged in farming operations whose aggregate debts do not exceed $1,000,000 if not less than 80% of the aggregate noncontingent, liquidated amount of those debts, at the time the case commences, arise out of a farming operation owned or operated by such person and the person received from such farming operation more than 50% of such person's gross income for the taxable year preceding the commencement of the case, or

(B) a corporation in which more than 50% of the outstanding stock of or equity is held by a person conducting the farming operation, and

(1) more than 80% of the value of its assets consists of assets related to the farming operation;

(ii) its aggregate debts do not exceed $1,000,000 if not less than 80% of the aggregate noncontingent, liquidated amount of those debts, at the time the case commences, arise out of a farming operation of such corporation; and

(iii) if such corporation issues stock, such stock is not publicly traded;

(2) "debtor" means family farmer; and

(3) "debtor in possession" means debtor except to the extent that the court orders otherwise.

Amend "Section 1. Definitions" of H.R.2211 so the definition of family farmer is the same as above.

Comments to Exhibit 8

Present Law: There is no provision in the present Bankruptcy Code which defines "family farmer".

S.2249: Family farmer is a person with debts of not more than $1,500,000 (80% of which arise from the farming operation) and at least 50% of whose gross income in the taxable year prior to the filing arose from the farming operation. If the debtor is a corporation, in addition to the same debt limitation and debt percentage tests a person must satisfy, at least 50% of the stock must be held by the person conducting the farming operation and the stock cannot be publicly traded.

H.R.2211: Family farmer is a person with debts of not more than $1,000,000, at least 80% of which arise from the farming operation. If the debtor is a corporation, in addition to the same debt limitation and debt percentage tests a person must satisfy, at least 50% of the equity securities must be held by one family and, if stock, the stock cannot be publicly traded.

Proposed Amendment: The proposed amendment takes the Senate provision and modifies the debt limitation test with that found in the House provision.

The amendment to Chapter 12 requires the debtor to be engaged in the farming operation and for the debtor to receive a minimum amount of his gross income from the farming operation. It is essential that the definition of a family farmer contain an income component to prevent abuses by individuals not intended to be protected by the chapter, e.g. "hobby" farmers.

The amendment also requires that a corporation be owned by the person conducting the farming operation to be eligible for protection under Chapter 12. It is assumed that the proponents of Chapter 12 intended to only allow corporations held by "family farmers" to be eligible debtors and not corporations involved in agricultural activities which are being held solely as tax shelters.

In addition, the amendment deletes the "production of agricultural products" language of the present Senate provision and substitutes "farming operations." This is consistent with the present definition of farmer. "Farming operation" is defined in the present Bankruptcy Code whereas "production of agricultural products" is not defined.

EXHIBIT 9

Amend Subsection (d) of "Sec. 1211. Who May File a Plan" of S.2249 to read as follows:

> (d) On request of a party in interest made within the respective period specified in subsections (b) and (c), and after notice and a hearing, the court may for cause, reduce the 240-day period or the 300-day period referred to in this section.

Delete from Subsection (b) of Sec. 1211, "The court may not extend this time period unless substantially justified."

Comments to Exhibit 9

Present Law: The Bankruptcy Code currently allows the court, for cause, to reduce or increase the debtor's exclusive 120-day period to file a plan and the debtor's exclusive 180 day period to file a plan that has been accepted.

S.2249: The bill extends the family farmer's exclusive filing periods from 120 to 240 and from 180 to 300. The bill allows the court to increase these periods only if its substantially justified.

H.R.2211: The bill extends the exclusive filing periods for family farmers filing under Chapter 11 from 120 days to 240 days and from 180 days to 300 days. The court may increase or reduce these periods for cause.

Proposed Amendment: The proposed amendment eliminates the court's authority to extend the debtor's exclusive periods under Chapter 12. Thus, if a family farmer has not filed a plan after 240 days, another interested party may file its own plan. The debtor, of course, is still free to file its own plan at any time.

Although this amendment differs from present law, not permitting an extension of the debtor's exclusive filing period is quite justified and not unduly burdensome to the debtor; under the bills, the debtor already receives a very generous exclusive filing period — eight months -- which is twice the length of the period allowed any other debtor. Because creditors already are forced to wait an extra four months for a plan to be filed and for any progress on the bankruptcy process, it is fair to then at least guarantee that there will be some movement in the process after eight months.

EXHIBIT 10

Amend "Sec. 1210. Conversion or dismissal" to add to subsection (e) after part "(10) nonpayment of any fee and charges required under Chapter 123 of title 28," a subsection (11) which reads as follows:

> "failure of the debtor to comply substantially with Sec. 1204(d) of this Chapter."

Amend "Sec. 1209. Removal of a debtor as debtor in possession and after part "(2) if it is not in the best interests of creditors for the debtor to be a debtor in possession," add:

> "(3) for failure of the debtor to comply substantially with Sec. 1204(d) of this Chapter."

Comments to Exhibit 10

Present law: There is no provision in the present Bankruptcy Code that requires a debtor to file a report indicating the status of the case and the debtor's intentions.

S.2249: A family farm debtor must within 60 days after the date of filing and at 60 day intervals thereafter, file a report that includes a statement of intention with respect to the disposition of property of the estate, projections of income and expenses for the debtor's farming operation and in general terms, a statement of the debtor's strategy for reorganization.

H.R.2211: No similar provision.

Proposed Amendment: The proposed amendment adds to the specified list of examples of causes for dismissal of a case and causes for removal of a debtor as a debtor in possession, failure to file the report as required by Sec. 1204()a) of Sec. 2249. That section requires a debtor to file with the court in 60 day intervals a report indicating the status of the case and the intent of the debtor.

In his remarks addressing this "snapshot" report, Senator Grassley stated, "material failure to comply with this provision shall constitute cause to remove the debtor in possession under sections 1205 and 1209, or to dismiss the case under section 1210." However, nowhere was this made explicit in the sections of proposed Chapter 12. Indeed, the proposed Chapter is silent on the matter.

The proposed amendment would simply implement the intent of Senator Grassley by adding failure to file properly the required report to the list of causes to remove a debtor as debtor in possession and list of causes for dismissal.

EXHIBIT 11

Amend Section 4 of H.R.2211 to add a subsection (d) which reads as follows:

(d) Section 1107 of title 11, United States Code, is amended by adding a subsection (c) which reads:

"(C) In the case of a debtor who is a farmer, within 60 days after the date of the filing of a petition under this chapter, and at 60-day intervals thereafter, or within such time as the court, for cause, may allow, the debtor shall file with the clerk a report which shall include a statement of intention with respect tot he disposition of property of the estate, projections of income and expenses for the debtor's farming operation, and in general terms, a statement of the debtor's strategy for reorganization."

EXHIBIT 12

Insert after Sec. 1203. Trustee, the following:

"(a) At any time after the commencement of the case but before confirmation of a plan, on request of a party in interest, and after notice and a hearing, the court shall order the appointment of a trustee if such appointment is in the interest of creditors, any equity security holders, and other interest of creditors, any equity security holders, and other interests of the estate, without regard to the number of holders of securities of the debtor or the amount of assets or liabilities of the debtor.

(b) If the court has appointed an individual under section 1302(d) to serve as standing trustee in cases under Chapter 13, and if such individual qualifies as a trustee under section 322 of this title, or if a trustee has been appointed pursuant to Chapter 15, then such individual shall serve as trustee if the court orders the appointment of a trustee under this chapter. Otherwise, if the court orders the appointment of a trustee under this chapter, the court shall appoint a person to serve as trustee."

Delete "(b)" under Sec. 1203 and add "(c)" in its place.

Delete "(c)" under Sec. 1203 and add "(d)" in its place.

Delete "(d)" under Sec. 1203 and add "(e)" in its place.

Comments to Exhibit 12

Present Law: Under Chapter 11, trustees are appointed upon request of a party in interest for cause, including fraud, dishonesty, incompetency, gross mismanagement or if such appointment is in the interest of creditors. Under Chapter 13, the court automatically appoints a trustee.

S.2249: The court automatically appoints a trustee under Chapter 12.

H.R.2211: Same as current law.

Proposed Amendment: The proposal allows the court the discretion to appoint a trustee when it is requested and necessary. Although there are instances when the trustee is useful and helpful, there are occasions where the cost and expense of a trustee to the estate are unnecessary. We recommend that the court be allowed the flexibility of refraining from appointing a trustee to avoid an unnecessary expense to the estate.

EXHIBIT 13

H.R.2211 is amended to add a new Section 9 which reads as follows:

SEC. 9. CONFIRMATION OF PLAN.

(a) Section 1325(b)(1)(B) of title 11, United States Code, is amended by striking out "in the three-year period".

(b) "SEC. 9" of H.R.2211 is amended to read "SEC. 10".

(c) "SEC. 10" of H.R.2211 is amended to read "SEC. 11".

Comments on Exhibit 13

Present Law: Under the present provisions of the Bankruptcy Code the Chapter 13 debtor is able to have its plan confirmed so long as all of the debtor's disposable income during the first three years of the plan is paid to the unsecured creditors.

Disposable income is defined as income which is received by the debtor and which is not reasonably necessary to be expended for (a) the maintenance or support of the debtor or a dependent of the debtor or (b) the payment of expenditures necessary for the continuation, preservation, and operation of the debtor's business.

S.2249: No similar provision. Inapplicable.

Proposed Amendment: The amendment requires the debtor to pay its disposable income to the unsecured creditors throughout the term of the plan.

The disposable income requirement of the present provisions of Chapter 13 was drafted with the three-year plan period in mind. In general, Chapter 13 plans only last for three years unless the debtor can show cause to have the time period extended.

The amendment takes into account that family farmers' plans under the House bill may last 10 years and requires a farm debtor to make its disposable income available for payments to the unsecured creditors throughout the term of the plan. The amendment merely makes the provisions compatible and consistent with the other provisions of Chapter 13 that do not apply to family farmers.

EXHIBIT 14

Delete "Sec. 1225. Emergency care of stock."

EXHIBIT 14.5

Section 1225 of S.2249 is amended to read as follows: "Sec. 1225. Emergency Care of Stock."

(a) The court may authorize the obtaining of credit pursuant to Section 364 for the care, including feeding of stock owned by, or in the possession of, a debtor without notice or a hearing where the court finds that credit is needed to obtain funds to care for stock, an emergency exists and that immediate and irreparable injury, loss, or damage, will result if authorization to obtain credit for the care of stock is delayed and that it is in the best interest of the estate to obtain credit and care for the stock.

(b) All ex parte hearings held pursuant to the provisions of subsection (a) on a request of the debtor for the authorization to obtain credit shall be conducted in open court and a record thereof shall be made.

(c) [Notice shall be immediately given, by mail, to all creditors of entry of the order authorizing credit under this section and a copy of the order entered by the court hereunder shall be attached to the notice.] Such notice shall also specify the date by which a creditor or other party interest must file a request for a hearing on the relief granted by the court.

Comments to Exhibit 14 and 14.5

Present Law: The present Bankruptcy Code has no provision permitting the debtor to obtain ex parte court approval of emergency financing for the feeding of livestock.

Section 364 enumerates four situations in which the trustee or debtor in possession may obtain credit. Three of these situations require notice and hearing before the court approves the credit request. The fourth situation permits credit to be obtained without notice and a hearing.

S.2249: The bill allows obtainment of an ex parte court order authorizing a debtor to obtain credit for the emergency care of livestock. The only notice requirement is that all creditors must be sent a copy of the order authorizing the credit.

H.R.2211: No change from present law.

Proposed Amendment: This provision under S.2249 should be deleted because it is unnecessary and deprives creditors of an important right.

Currently, the only time a trustee or debtor in possession may obtain or incur unsecured credit is when it is incurred in the ordinary course of business. In all other situations, the Code requires approval by the court after notice and the opportunity for a hearing before a trustee or debtor may obtain credit or incur debt. A hearing is only held when one is requested by a party in interest.

Bankruptcy Rule 9013 provides that the request for an order be by written motion. Bankruptcy Rule 9006(d) requires that any written motion and notice of any hearing thereon be served not less than five days before the time of the hearing. The court may vary the time period for service of the motion and notice.

Since the hearing can be conducted after only five days notice and the court has the discretion to shorten this time period, there is no need for an ex parte hearing without notice for court approval of a credit request. The debtor surely should be able to anticipate that feed will be needed in five days.

The difficulty with the provision of S.2249 is that creditors find out about approval to obtain new credit after the request is granted. This contrasts with the normal provision that allows parties in interest to request a hearing before the court grants the request to obtain credit.

A great problem arises when liens are granted to new creditors. Under Section 364(d), the court may approve a credit request and authorize the debtor to grant an equal or senior lien on estate property that is already encumbered. Under S.2249, then, a creditor may not learn that its first lien position has been reduced to a second lien position until after the change. The creditor then has the burden of challenging the court order.

The burden is compounded by Section 364(e) which provides that even if the order authorizing the credit and lien is reversed on appeal, the lien position granted is not affected so long as the credit was granted in good faith. Thus, even if successful in challenging the order, the creditor still loses its first lien position. Knowing this, it is unlikely and quite fruitless for a creditor to pursue reversal of the order since nothing can be gained. In practical terms, then, the creditor has no opportunity to challenge the approval to obtain credit, even when it stands to lose its important first lien position.

If this position must be retained, it should at the very least allow some minimal protections as offered by the alternative amendments.

Although there is no specific provision in the Bankruptcy Code allowing such relief on an ex parte basis, the legislative history of Section 102(1) regarding the rule of construction of "after notice and a hearing" provides:

> In very limited emergency, there will be insufficient time for a hearing to be commenced before an action must be taken. The action sought to be taken may be taken if authorized by the court at an ex parte hearing of which a record is made in open court. A full hearing after the fact will be available in such an instance.
> 124 Cong. Rec. H11., 090 (daily ed. Sept. 28, 1978); 129 Cong. Rec. S17, 407, (daily ed. Oct. 6, 1978).

Congress clearly recognized that there would be a few emergency situations where the court would have to act on an ex parte basis. However, Congress also clearly intended that (1) such ex parte order would be made after a hearing in open court of which record is made in full court, and (2) a full hearing would be available for creditors to contest the granting of the ex parte order. The proposed alternative amendments add these protections which Congress surely envisioned and S.2249 omits.

EXHIBIT 15

THE CONCEPT OF THE ESTABLISHMENT OF A GUARANTEED FARM CREDIT AUTHORITY FOR USE IN FUNDING FARM LOANS THROUGH COMMERCIAL BANKS

The idea behind this concept is to provide ag borrowers with a lower cost source of funds than what is currently available through present programs. This concept could also allow community banks to compete more effectively with large regional banks and the farm credit system by allowing these community banks access to a more national funding source. Thus, the local bank could become a dependable source of reasonably priced loans for agriculture.

FUND PROCUREMENT - Establish a Guaranteed Farm Credit Authority to procure funds from the private sector (as opposed to using government funds). This authority would issue and sell government guaranteed bonds in a manner similar to the methods now used by the Farm Credit System. (These bonds would have to carry a government guarantee in order to insure the lowest possible costs to borrowers. While this would expose the government to some additional risks, this exposure could be minimized by methods discussed later in this text.) These funds could then be used to purchase participations in ag loans in commercial banks.

PROGRAM ADMINISTRATION - There are three ways to cover the administrative costs associated with the establishment and operation of the Authority. One method would be to charge a ½% "surcharge" on the funds used to purchase the participations - e.g. if the bond carries a 6% interest rate, the funds would be available to the originating bank for 6½%.

A second alternative to cover these costs would be a requirement that all banks that want to become an originating bank, invest capital in the Authority in proportion to the size of their deposit base (bigger banks will make a larger capital contribution). This capital could be used to help fund participations as well as provide a reserve for losses. Earnings from this capital contribution would cover costs. Thus, this method would reduce risk and costs to the goverment, but would probably also increase costs to the borrowers in that originating banks will charge higher interest rates in order to recover the costs of their capital contribution.

A third method of administrating the Authority would be to make it a part of the Farmer's Home Administration. If this method were used, then the FmHA could use the funds to purchase participations in guaranteed loans, rather than just guaranteeing a percentage of the loans. This method would keep the risk to government at the same level as now incurred under the guaranteed loan program, while slightly increasing the administration costs of the original guaranteed loan program. It is possible that these increased costs could be handled by charging a slightly higher fee on an "FmHA participation loan" (say 1½% of the participated portion of the loan) versus what is charged on a guaranteed loan.

Of these three methods, the first alternative of a ½% "surcharge" on funds used would probably encourage greater use of the program while providing lower cost funds for borrowers. The last alternative would involve less risk and more control of the funds by the government. In considering which route to take, the overall goals of the program must be kept in mind.

PROGRAM IMPLEMENTATION - At its option, an originating bank could apply to the Authority for purchase of a participation in any given ag loan from the originating bank. Depending on the level of risk, the Authority could purchase anywhere from 50% to 90% of a qualified loan. Since the Authority will be buying an outright participation in these loans, it could discourage the riskier loans by forcing the originating bank to use a greater percentage of its own funds to fund those loans. In addition to this, strict guidelines may be adopted to cull out imprudent loans (or those loans that should be made by FmHA on a direct basis). For a policy of what may be considered "prudent" lending guidelines, the Authority may want to adopt loan criteria similar to that used by MASI.

To cover administration costs, the originating bank may be allowed to charge a maximum of ½% interest over the cost of acquiring the funds from the Authority on the participated portion of the loan. On the portion of the loan that must be funded from bank funds, the bank may charge the normal bank rates necessary to cover the cost of funds, reserves, loan losses, etc. on the non-participated portion of the loan. The effective rate to the borrower will be a blend of these two rates that may be most easily explained by the use of an example. Consider the following:

Assuming a $100,000 loan on farm real estate

$10,000 funded from bank funds at the banks normal 11% rate	$90,000 funded from the participation by the Authority at 7½%
costs are covered in above rate	½% markup to cover costs to bank
farmer pays 11% on $10,000 or $1100.00 per year (first year)	farmer pays 8% on $90,000 or $7200.00 per year (first year)

Total interest cost to the farmer the first year is $1100.00 plus $7200.00 or $8300.00 for an effective 8.3% interest rate on the $100,000 loan.

Obviously the costs to the farmer-borrower will be directly influenced by the level of Authority participation. However, if the risk is such that the level of Authority participation may be low, then the borrower may be eligible for direct FmHA lending at reduced rates.

It is also important to note that the example assumes the use of the ½% surcharge to cover program costs. Any other alternative would change the effective rate as shown above.

LOAN SERVICING - The originating bank becomes responsible for the cost and time necessary to service the loan including, but not limited to, the costs of securing and documenting the loan, collateral inspections, annual financial statements, etc. The originating bank is also responsible for collecting payments as due, and applying the principal payments on a pro-rata basis to the participated and non-participated portions of the loan. With these payments, the originating bank will also collect the interest necessary to pay all accrued interest on the participated and non-participated portions of the note. The originating bank is then responsible for forwarding to the Authority the pro-rated principal payment and the portion of interest owed to the Authority.

In the event of deviations from the accepted loan agreements, or in the event of default on repayment, the originating bank must notify the Authority no later than the end of the next business day. At that time, the bank must also inform the Authority of steps that will be taken to collect the loan. In the event of complete default, the cost and time necessary to collect the loan will become the responsibility of the originating bank, but all losses will be shared between the bank and the Authority on a pro-rata basis in direct proportion to the percentage of the loan held by each party.

BOND MATURITES - This will be the most difficult area for the Authority to address in that the best policy would involve precognition of interest rate trends. The best policy would probably allow for the mixing of short-term and long-term maturities in order to blend rates to get the lowest rate possible for borrowers, wnile allowing some degree of stability. (Currently, one-year T-bonds are trading around 7.75% and ten-year T-bonds are trading around 10.125%). In order to adjust to changes in interest costs, the Authority must be allowed to vary the interest rates it charges the originating banks, or else be forced to buy bonds for the appropriate length of time as the repayment terms provided for in the loan. Should the Authority be allowed to vary the interest rate charged to the originating banks, then the banks must then be allowed to vary the rates charged to the borrowers.(To summarize the above, a decision will have to be made as to whether to provide a higher cost fund with a fixed interest rate, or a lower cost fund with a variable interest rate. When this is decided then decisions can be made regarding bond maturities).

Senator GRASSLEY. Tom, I would like to have your opinion on whether or not the Federal banking regulators are treating small Iowa agricultural banks more harshly than banks connected with energy, you know, Texas, Oklahoma-type banks, or the large international lenders.

Mr. HUSTON. While I was superintendent of banking I tried very hard to treat each and all and every size bank in Iowa absolutely the same. I got some flack from some of the larger institutions and larger holding companies at times, but I paid no attention to it and drove on. But bank regulation is not an even science. It never has been. I don't know whether it ever could be.

Smaller banks, ag banks, smaller energy banks, so on are different in their makeup and their acitivity than the very large banks. And it has always been my opinion that the large—not here in Iowa, but the large in our country do enjoy a position of strength that we do not enjoy here. There is a Federal Financial Institutions Council that meets. They are supposed to be coordinating bank regulation so that all situations will be handled the same. But I really doubt if it maybe can even be done.

Senator GRASSLEY. So you don't venture a guess whether or not Iowa banks are judged by stricter standards than——

Mr. HUSTON. I'm sure we are judged by stricter standards. Yes; I am sure.

Senator GRASSLEY. They are being treated more harshly?

Mr. HUSTON. Yes. I have no question about it.

Senator GRASSLEY. To Tom again, do you think the Federal assistance should be given to the Farm Credit System? Should have assistance been given even last winter?

Mr. HUSTON. Senator Grassley, I was saying 2 and 3, 4 years ago that before this is all over there's going to be a lot of cost to the Federal Government. And we are just getting closer and closer to the day that those costs will be there. I also made the remark that the longer you wait, the more it will cost and I think you're seeing the costs mount.

Yes; I am in favor of trying to save the Farm Credit System. We need a long-term lender. There is no long-term lender right now, Senator. I listened to some of the figures and all this and that, but the real facts are very few people can qualify for a farm mortgage loan today, a new customer.

There's all kinds of reworking them and all this and that, but very few can walk in and borrow money today. Maybe very few want to. But very few loans are being made and we have to get a farm real estate lender back in the market before we have a chance to stabilize land price.

Senator **Grassley**. Do you think that any strings should be attached to that help so that Farm Credit System isn't unfairly competitive or has an unfair advantage over commercial banks?

Mr. **Huston**. I worry about the competitive advantage that they enjoy and they certainly used their muscle all throughout the last half of the 1970's and early 1980's. And if you take a look at their growth rates, they're just astronomical. I would also say that would they have had proper regulation during that period of time they might have held their growth rates in line and might not have been so inconsistent in pricing their services which they found out, of course, they had priced way too low.

I do worry about the competitive disadvantage that commercial banking would be in. You know, isn't it interesting how the mutually owned or the Government entity, FDIC, they can go to the Treasury and get a blank check if needed? FSLIC can go to the Treasury and get a blank check if needed. The Farm Credit System can go to the Federal Treasury and get a blank check if needed. The commercial bank out here if needed and it isn't around, it was another one I had to close. And I closed 15 of them in my 10 years. Now we have lost another 11 in the State since I left office this year. So I do worry about the competitive inequality and somewhere the idea of mutually owned and capital requirements in those mutually owned are going to have to start matching the capital requirements in the privately owned. I have talked about this for several years, especially with Congressman Leach.

Senator **Grassley**. I have no further questions. I thank each of you for your participation. And I want to tell you that you have lended a perspective that we need to consider and don't often enough consider. Thank you.

Mr. **Huston**. Thank you, Senator.

[Prepared statements and material follow:]

PREPARED STATEMENT OF THOMAS H. HUSTON

This testimony was written and delivered on September 3, 1986, by Thomas H. Huston, President of the Columbus Junction State Bank, Columbus Junction, Iowa, for the Senate Judiciary Subcommittee on Administrative Practice and Procedure chaired by Senator Charles E. Grassley of Iowa.

Senator Grassley,

I thank you for inviting me to testify today and suggest that you hold frequent hearings on these subjects so you will be current at all times. My remarks are my opinions. I believe them to be accurate.

Your letter of August 19, 1986, asks what the Farm Credit System, commercial banks, and the FmHA are doing to resolve the farm credit crisis and also what actions are necessary for family farmers to receive credit this next spring. You also are interested in possible changes the federal government could make in their policies to facilitate farm debt restructuring.

My first statement, which is not new to you, is that the banks, FmHA, and the Farm Credit System cannot resolve the farm credit crisis as they did not cause it, anymore than did the farmers cause it. The regulators of the financial institutions did not cause it either. The cause of this crisis in agriculture is quite a lot the same as the crisis in textiles, lumber, steel, auto and farm equipment manufacturing, and oil. Economic forces that have responded to U.S. government policies and policies of other countries bring these fruits, and they are bitter instead of sweet. These problems have been building for years and cannot be laid at any one administration doorstep, not on any one political party. We all have played our parts over time and have reacted to the conditions that have now changed.

Now to be more specific concerning financial institutions and their regulators.

1. Capital forbearance

It is my understanding that very few plans for banks in Iowa have been submitted. I am told about 12 plans at the most in Iowa and none have been approved to date. It seems that banks with low capital and reserves to total asset ratios that need forbearance are either unable to put a satisfactory plan together or if they have a possible plan, they are deemed to not deserve approval. I am not aware of any effort by regulators to help devise an acceptable plan and it appears that attorneys and accountants, along with bankers, are trying to make the plans acceptable. Capital forbearance is relatively new to bankers and regulators and it has not been easy for either to know how to proceed.

According to some public written information available, one could get the idea that 6 percent is a minimum satisfactory capital figure for banks. What is being asked now, however, is 6 percent plus an adequate loan loss reserve that could run several percent more, which really means most banks are expected to have 8 percent or more. Of course, it is the bank that is having difficulty that is short on capital and it is the same bank that is being asked for the higher figure. Iowa wants all banks to have 8 percent, but there are many banks that are in the 7 percent to 8 percent bracket. At the present time, there are 32 state banks with capital and reserves below 7 percent. When I became Superintendent of Banking in 1975, there were over 100 state banks with capital and reserve ratios of less than 7 percent. By 1980, just a few state banks were below 7 percent. What is adequate capital for banks has been argued for years; and as far as I know, there is no answer other than what people demand.

2. FASB 15

This accounting policy was adopted on or about 1979 according to what I understand. It was devised as a method to handle the financial crisis for New York City. It was not generally known to bankers or most bank regulators until the spring of 1986. Few bankers know how to use it and regulators are somewhat skeptical. The policy is deemed to be sound and could be used more if accountants, bankers, and regulators knew more about it. Any policy like this that has not been used in banking can cause bank regulators to add additional requirements or stipulations that can render the policy useless. Time will tell how helpful FASB is, will, or can be. It is consistent with federal policy, however, because it requires true debt restructuring which is needed for many farmers and other businesses at this time.

I will be happy to respond to your questions.

Thank you.

Senator GRASSLEY. Our final panel this morning will consist of Bob Pim, the State director of the Farmers Home Administration, and Mike Thompson, the executive director of the Iowa Farmer/Creditor Mediation Service. I thank each of you for coming. I haven't had a chance to talk to Mr. Thompson since he got to his new position and it's not my position to welcome you to a State position, but I am glad to have the opportunity to meet you in your new position and to encourage you as much as I can, as I'm sure you're trying to do, to help us get through these troubled times that are here and are still ahead.

Mr. THOMPSON. Thank you.

Senator GRASSLEY. I guess I would start with Bob to speak first and then Mike Thompson and then I will—before you do that, just a minute. I just wanted to check to make sure how my time was. I think we are all right. Would you go ahead?

STATEMENTS OF A PANEL CONSISTING OF BOB PIM, STATE DIRECTOR, FARMERS HOME ADMINISTRATION, AND MIKE THOMPSON, EXECUTIVE DIRECTOR, IOWA FARM/CREDITOR MEDIATION SERVICE

Mr. PIM. Thank you, Senator. Accompanying me today is Jeanne Kling who is right here, who is a member of congressional affairs in our national office. I appreciate the opportunity to be with you today and to discuss the activities of Farmers Home Administration in Iowa.

These have not been the best of times, as you know, for the farmers of our State, but we at Farmers Home have been doing everything within our authority to help them over their current financial difficulties. We believe the worst is behind us, however, and that conditions will improve next year. Taken out of context that statement may be misconstrued, but I think there are several reasons why I want to put that in the record.

So far this year Farmers Home has extended more than $470 million in credit to Iowa farmers. That breaks down into $416 million in operating loans, $51 million in ownership loans and almost $4 million in disaster loans.

In each of the basic programs, operating and ownership, the Iowa figures amount to more than 10 percent of the agency's national total I am told. In the last 2 years Farmers Home has loaned over $1 billion in Iowa and over $1½ billion the last 3 years. That's loaned and guaranteed. In the last 2 of those 3 years Iowa has far exceeded any other State. This is not surprising in light of the intensity of agriculture in Iowa.

The operating loan activity reflects the emphasis now being given to guaranteed over direct loans in this administration. In Iowa this year we have just made about $200 million in direct operating loans compared to $215 million in guaranteed operating loans. Ownership loans are $27 million in direct and almost $24 million in guaranteed lending. The trend to guaranteed versus direct is expected to continue.

A new feature this year authorized by the 1985 farm bill is the interest buy-down. Under this authority Farmers Home can match up to 2 percentage points, a reduction in interest by a commercial lender on a guaranteed farm loan. The net result can be as much as 4-point reduction in interest for a farmer. Farmers Home pays the matching amount to the lender over a 3-year period.

This important new way to help farmers has started to work well in Iowa. We have entered into buy-down agreements for more than 400 loans totaling $36 million. We represent about 30 percent of the national total.

Farmers Home has recently made a major adjustment in the buy-down program to make it more consistent with our regular guarantee and to remove some of the criticism from the lenders. We now permit a balloon payment at the end of the buy-down period which will make it easier for a farmer to develop a positive cash flow needed to obtain the loan. This year's lending season is pretty well behind us now, but this change will be of considerable benefit to farmers and lenders next spring.

In the same spirit of trying to give an added lift where possible, Farmers Home this year adopted a practice called operation assist. Under this program we in the county office take a borrower to the lender to work out a guaranteed loan in the case there's some resistance from that lender to make the guaranteed loan.

Since we began the operation in late spring Farmers Home county offices in Iowa helped 63 farmers who otherwise would have been left without credit. We represent 13 percent of the national total under that operation assist.

There is a category that we do not lead the Nation in that I'm proud to say we have less farms in inventory than some of our neighboring States. We have now about 250 farms in inventory representing about 52,000 acres. We represent 5 percent of the national total.

Currently when we take farmland into inventory our first action is to offer the previous owner or operating operator the opportunity to lease it back as required by last year's farm bill. We are in the process of surveying those persons who might be eligible to take advantage of this provision and expect to know the results quite soon. As you know, we are now at the critical time of year for leasing farms.

Practically all the inventory now in our hands is being leased for farming and is not up for sale. We do not anticipate selling any of that property until land values stabilize so we do not run the risk of jeopardizing values in the particular community where the farms are located.

We expect Farmers Home in the coming season to take a very active role as we have in the past. We do not expect to be the only lender, however. The emphasis will be on guarantees as I mentioned and we will be working more closely than ever with lenders to ensure this success. Guarantees are working. We know of no unexpected burdensome loss rate so far.

Funding will depend, of course, upon decisions made in Washington by you and your colleagues in the Congress and in consultation with members of this administration. I have heard nothing to indicate that this agency will not have sufficient resources to meet the need. That completes my statement, Mr. Chairman. I will be glad to answer any questions.

Senator GRASSLEY. OK. Mr. Thompson.

Mr. THOMPSON. Senator Grassley, ladies and gentlemen, in reviewing the activities I've had in the Farm Credit field I found that the conflict has intensified in the last year. While the press and the public speak of a crisis, I think the conditions in Iowa reflect a chronic condition of disrepair and economic decay. The impact on farmers is obvious, foreclosures, bankruptcies, emotional maladies, and divorce, but the impact for creditors is equally obvious, job displacement, bank foreclosures, requests for Federal assistance, and emotional upheaval. I think recognition of the woes of the farmer and the creditor need to be more publicized and understood.

As a mediator and a representative of the Farmer/Creditor Mediation Service I'm responsive to both sides. While mediators help the parties negotiate the best settlement, a mediator does not make decisions for either side and he or she is not an advocate for a particular outcome.

Instead, the mediator assists parties in communicating proposals, developing options, and defining emphasis. I think the latter may be the most important thing to look at. Most of the folks that come to us at this point in time are at a stage of impasse and I think it's in that stage that we really have to understand they are emotionally charged.

During the last 11 months our service has changed from a voluntary project to one that is voluntary and mandatory. The caseload has increased from 25 to 50 cases a month to about 1,000 cases a month. The increase has resulted in implementation. Our staff has stretched them to the limits. We have over 200 mediators here now trying to conduct mediations in the State and preliminary statistics show that 50 to 60 percent of the cases that are mediated have positive outcomes.

It is not necessarily keeping a person on the farm or a family there but helping them make an informed decision. Note that our success rate does not include those cases where farmers waive their right to mediation or give up that right.

In reviewing our outcomes it's evident there are some crucial points to look at. Preparation makes mediation work. In those cases where farmers are prepared, mediations have a greater likelihood of successful outcomes. To be adequately prepared, farmers and creditors both need to review financial, emotional, legal, social, and familial dynamics.

I'm afraid that most of the people we see aren't prepared in very many of these fields and most of them focus on the financial data and forget the other parts. I think if we don't deal with the other parts, what happens is the negotiations tend to break down. I think a second part that we have to look at is the perception of the stereotype of the other party. I think it's easy, for example, for example, to cast aspersions on the Farm Credit System. It's easy to paint them as the worst person in the world, but it usually results in a negative outcome.

The experience of our service has been that farmers and creditors ideas about what risk is and one of the most important things we found is if we can minimize the stereotyping, work can be done.

Our most recent experience with the Farm Credit System has been that they do demonstrate good faith bargaining. In most other cases where negotiations reach an impasse they try to define what the risk is. I think what that should tell us is they're trying to move in a direction of negotiating and trying to resolve the problem.

In concluding my speech here, the experience of our service suggests that mediation can be an effective tool. It's going to only be an effective tool if we can continue working with farmers, farmer groups, and creditors alike. I think one of our most important issues is going to be trying to find a way to keep these groups working together in the next year, not only to try to resolve problems on individual cases but to look at how we create legislation, how we create matters to bring to your attention on how to solve this problem.

Again, I don't think it's a crisis. I think it's a chronic condition of decay that's going to mean a lot to farmers and creditors alike to work it out. I think while we are going to be there to help people, other people are going to have to work too. The relations of our service can only be maintained, though, if we maintain a neutral stance, a stance that's not profarmer or procreditor but a stance designed to help the farmers and creditors work on the problem and look for mutual outcomes.

We think the stance will allow us to ask the difficult questions, the questions that need to be asked to the farmer as to whether his management skills allow him to stay on the farm or to the creditor whether he is able to implement something like FASB 15.

As the service grows and continues developing trust, we will be able to do more of this and we appreciate the opportunity to use this mechanism to resolve farmer-creditor disputes. Thank you.

Senator GRASSLEY. Thank you very much. Can you, Mr. Pim, tell me what's being done to ensure that county supervisors within the system are apprised of the changes in the interest rate buy-down regulations with regard to the balloon payments?

Mr. PIM. That was published within the last 10 days and they have been notified. The county offices have been notified by a procedure notice from the national office and I'm sure they are aware of the new procedure.

Senator GRASSLEY. In regard to that balloon situation, we became aware that only $5 million of the $490 million allocated for the buy-down program was by June 1. Then the problem with the balloon payments came to our attention. And I think within just a few days after we got to the USDA about it, which I think would take you down to around the 20th or 25th of June, they responded positively that it was going to be changed. And now it's almost 6 weeks later that the regulations are being read. Is that the way that worked out finally so you couldn't do anything to speed the process up?

Mr. PIM. That is correct. It took approximately that long to get the procedure through the system.

Senator GRASSLEY. Well, sometimes we don't get fast action from the policymakers in USDA on a lot of things we would like to, but at least on this one I thought we did get a quick response. Then to have it delayed by another 6 weeks and you can't do anything in the meantime——

Mr. PIM. That's correct.

Senator GRASSLEY. Maybe it's a combination of USDA and OMB. I don't know who takes so long to get these things approved, but there wouldn't be anything more satisfying to farmers out here who are having trouble if they could just once have the view of a panting bureaucrat running around trying to get something done quickly.

I mean, there wouldn't be anything that would do the Federal USDA or a lot of other departments more good than to be seen really trying to rush around and see that something is done.

You know, you're always caught up in things in Washington. Maybe I should have known these regulations went out, but I guess when I got this positive response from USDA the last of June, I thought, another one of those problems is behind us, let's move on to something else. It turned out that the whole process took 6 weeks, right?

Mr. PIM. As I recall it took about 6 weeks, yes, sir.

Senator GRASSLEY. Well, if anybody really wanted to help us out here, whether it be for economic reasons or political reasons, they should be speeding up the process. Just help us get some of these problems with programs already on the books solved so they work the way they ought to.

Congress makes a policy and then we turn around and have the regulation writers or some faceless bureaucrat in OMB just stymie the whole process. I don't understand what the game is.

I guess again, Bob, to you, do you expect that Iowa will continue to receive a higher percentage of the Farmers Home Administration funds for guaranteed and direct loans?

Mr. PIM. I have no reason to believe that we can't continue to be treated fairly well on the guaranteed end of the allocation. We have been active in the use of it and I think we can continue to believe that we will be funded adequately. It's very difficult to predict. With the emphasis on guaranteed loans nationwide there will be other States that will become active also, so the approporiations process will be important.

Senator GRASSLEY. One of the problems we have, Bob, is that it seems like in some counties things go all right and in other counties things don't go so well. So I need to ask in your position as State director what you do to ensure that county supervisors are complying with State procedures and don't just seem to be following their own whims, when it comes to making loans.

Mr. PIM. We do several things. We have several training functions during the year. We have a good relationship with the lending community, have meetings with lenders several times a year and have two-way communication with our county supervisors there. We have a review process from the State office where we have operation reviews in about a third of our offices annually. We go in and look at the accounts one by one and make an analysis of their management capabilities. There are other things that I probably am not recalling now, but we do several things to try to get uniformity. It's a management challenge and we continue to work on that daily.

Senator GRASSLEY. Well, are the reports we are getting that we have problems in this area accurate from our standpoint? I mean, I'm not saying that every report is accurate, but at least are enough reports coming in that you see it as really something difficult for you to deal with?

Mr. **Pim**. Well, it's always difficult to deal with a problem as complex and serious as the one we have in agriculture credit. We have, you know, a tremendous turnover in our personnel. We graduate a lot of our county supervisors to the other lending institutions of the State. They look at our personnel as well-trained and so we have new people going into our offices. So that is a challenge.

I will say this. From the guarantee point of view we have 600 lenders, bankers in the State. They also have a wide variation of experience in professionalism, so we do get challenged on that front. I do believe that Leslie Miller's comment about a group of lenders as an advisory group, working with Farmers Home, would be an asset.

I have talked to the president-elect of the Iowa Bankers Association and I think that an advisory council—I don't go quite as far as Ms. Miller does in her statement, but an advisory council, set up with lenders and Farmers Home working together to get uniformity, I think will be positive.

Senator **Grassley**. Is that something you can institute on your own?

Mr. **Pim**. Yes; we can, Senator.

Senator **Grassley**. So you have done that or you are going to do that?

Mr. **Pim**. Well, as I said, the president-elect of the Iowa Bankers Association and myself are working on this. I think he takes office October 1, if I'm not mistaken, so we will work on that and I'm sure that this is going to be one of his programs.

Senator **Grassley**. The General Accounting Office has reported that Farmers Home Administration may acquire as many as 20,000 farms through foreclosure by the end of 1987. Do you think that Congress should allow Farmers Home to sell acquired real estate?

Mr. **Pim**. Senator, as you know, I have an administrative position and I do have opinions and this will be my opinion, not the opinion of the administration. I think we need to go very slowly in selling farms out of inventory in Iowa until we see that land values have stabilized and we will not impact on this negativism in land values. I feel in Iowa we should not be selling inventory.

Senator **Grassley**. So at least your personal opinion is for at least some time, we shouldn't change the law?

Mr. **Pim**. That's my opinion.

Senator **Grassley**. I would just like to have a general view, and this really comes from a lot of constituents I have, whether or not acquired real estate ought to be put in conservation reserve.

Mr. **Pim**. My opinion again is that I don't believe that it should be.

Senator **Grassley**. Again, I might have one more question for you, but I want to hurry to ask Mr. Thompson some questions. Do you feel that there is a difference in how various types of lenders use your programs? And I would like to give you an example, Leslie Miller testified that of the first 1,500 requests for mediation that you received, 1,200 were from the Farm Credit System.

Mr. **Thompson**. That's somewhat accurate. I think the difference may well be looked at not so much in who brings the cases to our attention but it has something to do with how that law was written and how it's implemented. I guess underlying that question is, do creditors negotiate differently? Do they use their services differently? I think, of course, it depends upon their own situation.

We found, though, that most creditors are trying to use the service in the most productive means. They are trying to use the service as a means to resolve the problems they are facing in terms of handling a case that's delinquent to a point where they decide that foreclosure is an imminent action.

I would suggest that that means that each one of these entities who work with us will do things differently. We have not found any active opposition from any of the major groups in the State, whether that's the Farm Credit System, the Independent Bankers Association or FmHA.

Almost every one of the lenders we work with has worked with us to the point of trying to make sense of how this mediation law is going to be implemented. We are finding in individual cases regardless of whoever does it, there are some cases that can't be resolved through mediation. But overall I find that most of the groups are willing and want to work with us.

Senator GRASSLEY. If Leslie's figures are accurate as you say, and I didn't have any reason to question them, but your affirmation of that, wouldn't this indicate that the Farm Credit System is foreclosing is greater numbers than commercial lenders are?

Mr. THOMPSON. I'm not sure if I can make that statement. I think that just tells us the kind of case load we have gotten from the Farm Credit System and I think it might suggest that they are trying to work on their cases with us. I would suggest in many of the preliminary cases we have done with them they aren't going through with the foreclosures, so the question is, can they negotiate a settlement of something that is in their mind if they can use this process to come up with the best possible solution?

It's not indicative of the fact that they are trying to foreclose. It may well be a process they can use in their best interest to try to resolve the problem. I don't have a definitive answer in terms of comparing them to independent bankers or to FmHA. It doesn't appear that the other groups have that load at this point in time, but it doesn't mean they won't and it doesn't mean that we won't get a greater number of cases.

One thing we do know is about 40 percent of all the holdings that are done in Iowa are done with the Farm Credit System, so they may well have a larger number. We would like to try to work with them on that and we have been working with their staff. We don't have an adversarial system. In fact, we have the opposite. They are cooperating, we negotiate all the time on how to deal with this and I think we are moving ahead.

Senator GRASSLEY. Do you have a higher rate of success with the Farm Credit System or the commercial banks in resolving disputes?

Mr. THOMPSON. Preliminary evidence suggests it's about the same.

Senator GRASSLEY. Do you think that your program would be more effective if both sides were bound by the decision of the mediator?

Mr. **Thompson**. I think that would be a real important thing to remember. The mediator doesn't make the decision at least as mediation is used in Iowa. The idea behind mediation as we use it is the parties have to make the decision. Now, can that decision be something they can be bound by? Yes, it's something they can take to court if they want. Unlike other States, including Minnesota, the mediator may make a decision. I think that might be arbitration, not mediation. There is some confusion there.

I think what happens in our cases is those outcomes can be taken to court and applied and will be determined by a court and applied and will be determined by a court ruling whether they are valid or not. So it's my assumption right now until the court determines it, most of these cases can have valid and legal outcomes.

Senator **Grassley**. Should your program be expanded nationwide?

Mr. **Thompson**. We know this, that there are at least 10 other States that are interested in mediation. There are three other States that currently have mediation programs that are being done. I think our biggest impediment on a national level as well as on a State level is lack of funding for the kind of case load we are encountering. There is just not enough funds there to set up a program to readily handle the cases.

Senator **Grassley**. Would your mediation service be helpful in resolving disputes between bankers and the Farmers Home Administration or the Farm Credit System or in addition disputes between the FDIC and the borrowers whose loans were with a failed bank?

Mr. **Thompson**. I think we already see some of that happening in the cases we are doing, sir. In many of the cases we find we have to sit down not only with the lending groups as a group and try and negotiate with them, we also have to sit down with the family and deal with the problems internally there. I do think there are some national concerns about, how do they negotiate with other people? I think definitely FDIC, places like that, need to have some accountability measures built in. Whether mediation is the appropriate vehicle or not, it's certainly one method and we certainly would try to work on that kind of case.

Senator **Grassley**. Bob, the last question I was hoping I would have time to ask you, Farmers Home seems to be shifting its emphasis from direct lending to guaranteed lending. I shouldn't say seems to be because I think it's so obvious that, you know, you have to accept it. We still accept it in the sense of it being a fact, not accepting the extent to which thinking that's a good policy. In fact, I tried to get some money this summer for more direct loans.

Should any change be made in the operation of Farmers Home Administration Programs due to this change in emphasis? I could say, for instance, do you have any intention of expanding the approved lenders program?

Mr. **Pim**. The answer to that, Senator, is that it's going to take some time to make this switch. We have made good progress in this State, I believe, because of a lot of different factors. The lenders have been very receptive. They are very professional. They see the advantage to the program and have been very, very aggressive in using the guaranteed program.

I think that we're going to see a resistance in many other States where lenders haven't been as professional and as aggressive. It's going to take a tremendous amount of emphasis on my counterparts to make this work all over the Nation. And as far as in Iowa, we have to continue to be working together like I believe we are, looking at problems and trying to resolve them as they come about.

It's not to avoid a problem. We have to continue to work at them together. Mediation is helpful, Extension-service has been very helpful with the assist program and we've got many other things going I think that will continue to make it successful.

Senator **Grassley**. Let me say thank you to everyone who participated, not only this panel but all the panels. And also administratively remember that you have 15 days to submit something that anybody might want to submit for our consideration of the subcommittee. Those people who did participate have the same period of time to make any additions or corrections that they might want to make for the record.

In closing I would like to pledge my continued support for efforts to help family farmers with their credit needs, but I would like to stress strongly that each of those groups represented here today also have to do everything within their power to lower interest rates and to restructure farm debt and to keep family farmers on the farm. To do less I think would be selling out those good customers who have been so good to all of the various sections of agricultural lending for so many years.

I think it is clear that most of the farmers in trouble today are an essential part of our rural communities and I would like to think that we can't afford to lose one more even though realistically I suppose that's bound to happen even if we had a magic answer right today.

It is not going to be easy and we have a long road in front of us, but if we work together and we work hard, maybe we can move that recovery a little closer and make it happen a little faster. I stand ready to do my part and have started that process I hope with this hearing or even 1 year ago as we tried to bring out a lot of things that were so essential for the farm bill as well as the Farm Credit bill.

I thank you all for your input and the meeting is now adjourned.

[Whereupon, the subcommittee adjourned, subject to call of the Chair.]

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